# CS EXECUTIVE

NEW SYLLABUS

# SETTING UP OF BUSINESS, INDUSTRIAL & LABOUR LAWS

Paper-3

Module-I

CS GD SALUJA

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# Chapter 1 : Selection of Business Organization

## TYPES OF BUSINESS ORGANIZATIONS

Business organization refers to all necessary arrangements required to conduct a business in an optimized manner. It refers to all those steps that need to be undertaken for establishing and maintaining relationship between men, material, and machinery to carry on the business efficiently for earning profits. This may be called the process of planning and organizing which are the integral part of the business management. The arrangement which follows this process of organizing the factors required for commencing and carrying on the business is called a business undertaking or organization.

Choosing a form of business entity is crucial to a successful organization. The choice of a business entity will depend on an object, nature and size of the business of such entity which will be varied from case-to-case basis and will also depend upon the will of the owners of the business entity which they want to accomplish. The main types of business entities in India are:

- Sole Proprietorship,
- Partnership,
- Hindu Undivided Family (HUF) Business,
- Limited Liability Partnership (LLP),
- Co-operative Societies and
- Company which may be any kind of company including One Person Company (OPC), private company, public company, Guarantee Company, Subsidiary company, statutory company, insurance company or unlimited company.

There can also be Association of Persons (AOP) and Body of Individuals (BOI), Corporation, Co-operative Society, Trust etc.

## SOLE PROPRIETORSHIP

Sole proprietorship is a form of business, wherein one person owns all the assets of the business, no legal formalities are required to create a sole proprietorship other than an appropriate licensing to conduct a business and registration of business name if it differs from that sole proprietorship. The owner reports income/loss from this business along with is personal income tax return.

### Features of Sole Proprietorship

**Unlimited Liability:** Just as a partnership, a sole proprietorship has no separate existence. Therefore, all debts can only be recovered from the sole proprietor. Therefore, the owner has unlimited liability with regard to all the debts. This should heavily discourage any risk-taking, which means that it is suited to only small businesses. If one plans on running a business that requires a loan or may end up paying penalties, fines or compensation, it is best to look into registering an OPC.

**Easy to Start:** There is no separate registration procedure for proprietorships. All a person needs is a government registration relevant to the business. If one is selling goods online, a proprietor would only need a sales tax registration. Therefore, starting up as a sole proprietor is relatively easy.

## PARTNERSHIP FIRM

When two or more people come together and pool funds to start a business, it is known as a partnership firm. The primary aim of partnership firms is to earn profit. Partnership firms are created by drafting a partnership deed among the partners. Partnership firms in India are, governed by the Indian Partnership Act, 1932.Section 464 of the Companies Act, 2013 empowers the Central Government to prescribe maximum number of partners in a firm but the number of partners so prescribed cannot be more than 100.

The Central Government has prescribed maximum number of partners in a firm to be 50 vide Rule 10 of the Companies (Miscellaneous) Rules, 2014.

### Features of Partnership

**Unlimited Liability:** On account of unlimited liability, the partners in the business are liable for all of its debts. This means that if, for whatever reason, a partner is unable to repay a bank loan or is liable to pay a fine, this can be recovered from his or her personal possessions. So, the bank, institution or supplier would have right to their jewellery, house or car. Furthermore, aside from ease of set-up and minimal compliance, the partnership offers no benefits over the LLP. If one opts to register it, which is optional, it may not even be cheaper. Therefore, unless one is running a very tiny business, one should not opt for a partnership.

**Easy to Start:** If one chooses not to register the partnership firm, all that is needed to get started is a partnership deed. As compared with a private limited company or LLP, the procedure for starting-up a partnership firm is much simpler.

**Relatively Inexpensive:** A General Partnership is cheaper to start than an LLP and even over the long-term, due to the minimal compliance requirements, is inexpensive. One need not to hire an auditor. This is why, despite its short comings, home businesses may opt for it.

## HINDU UNDIVIDED FAMILY (HUF)

A Hindu family can come together and form a HUF. HUF is taxed separately from its members. One can save taxes by creating a family unit and pooling in assets to form a HUF. HUF has its own PAN and files tax returns independent of its members.

### Features of Hindu Undivided Family (HUF)

There should be atleast two male members in the family to form a HUF. They should inherit the ancestral property. All of the members enjoy this property and have an equal share in that property. Thus, any child taking birth in that family becomes a member of the HUF. There is no requirement for an agreement to become a member.

## LIMITED LIABILITY PARTNERSHIP (LLP)

Limited Liability Partnership is an alternate corporate business entity that provides the benefits of limited liability of a company but allows its members the flexibility of organizing their internal management on the basis of a mutually arrived agreement, as is the case in a partnership firm, introduced in India by way of Limited Liability Partnership Act, 2008. LLP

is relatively a cheaper approach to incorporate as compared to a Private Limited Company and requires fewer compliances; its main improvement over General Partnership is that it limits the liabilities of its partners to their contributions to the business and offers each partner protection from negligence, misdeeds or incompetence of the other partners.

### Features of Limited Liability Partnership

Suitable for Non-Scalable Businesses: If one is running a business that is unlikely to require equity funding, may register an LLP as it combines several benefits of the private limited company and general partnership. It has limited liability, like a private limited company, and has a simpler structure, like a general partnership.

**Fewer Compliances:** The Ministry of Corporate Affairs ('MCA') has given some concessions to the LLP. For example, an audit needs to be performed only if the turnover is greater than Rs. 40 lakhs or whose contribution is more than Rs. 25 lakhs. Furthermore, whereas all structural changes need to be communicated to the RoC in the case of private limited companies, the requirement is minimal for LLPs.

**Number of Partners:** There is no limit to the number of partners there may be in an LLP. If one is building a large advertising agency, for example, one need not worry about any cap on the number of partners.

## CO-OPERATIVE SOCIETY

A cooperative organization is an association of persons, usually of limited means, who have voluntarily joined together to achieve a common economic end through the formation of a democratically controlled organization, making equitable distributions to the capital required, and accepting a fair share of risk and benefits of the undertaking.

### Features of Co-operative Society

A society is an association of persons united together by mutual consent to deliberate, determine and act jointly for some common purpose. Societies are usually registered for promotion of charitable activities like education, art, religion, culture, music, sports, etc.

## SECTION 8 COMPANY

Section 8 company is a company established for promoting commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment or any such other object', provided the profits, if any, or other income is applied for promoting only the objects of the company and no dividend is paid to its members. Section 8 Companies are registered under the Companies Act, 2013.

### Features of Section 8 Company

Certain features of a Section 8 company can be summarized as under:

1. It is formed for promoting commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment or any such other object.
2. The profits, if any, are applied in promoting its objects.
3. It prohibits the payment of dividends to its members.
4. The name of the Company can be incorporated without using the word "Limited" or "Private Limited" as the case may be.

5. There is no requirement of any minimum paid up capital.

6. Flexibility of Administration

## ONE PERSON COMPANY

An OPC means a company with only 1 (one) person as a member. Share holder can make only 1 nominee, he shall become a shareholder in case of death / incapacity of original stakeholder. The constitution of a One Person Company (OPC) is a strong improvement over sole proprietorship. It gives a single promoter full control over the company while limiting his/her liability to contributions to the business. This person will be the only director and shareholder (there is a nominee, but with no power until the original member is incapable of entering into contract). Hence, there is no scope of raising equity funding or offering employee stock options.

### Features of One Person Company

For Solo Entrepreneurs: A big improvement over the sole proprietorship firm, given that the liability is limited, the OPC is meant for solo entrepreneurs. Furthermore, given that there must be a nominee, it enabled perpetual existence of the OPC.

Low Compliance Requirements: Various exemptions has been given by the Central Government to OPC such as: exemption from holding the Annual General Meeting of the company, financial statement and Board's report can be signed only by one director, it does not need to include Cash Flow Statement as part of its financial statement etc.

**Minimal Tax Advantages:** The OPC, like the private limited company, has some industry-specific advantages. But taxes are to be paid at a flat rate on profits.

## PRIVATE COMPANY

Private company is a company which has the following characteristics:

- Shareholders right to transfer shares is restricted
- Minimum number of 2 members in company
- Number of shareholders is limited to 200
- An invitation to the public to subscribe to any shares or debentures or any type of security is prohibited.

## PUBLIC COMPANY

A public company is a company which has the following characteristics:

- Shareholders right to transfer share is not restricted
- Minimum 7 members
- An invitation to the public to subscribe to any shares or debentures or any type of security is permitted.

## SELECTION OF A BUSINESS ORGANIZATION

Essentially, companies could be either private or public company. Public company could be unlisted or listed. A person must sit down and carefully consider all the advantages and disadvantages of each type of entity before choosing one of the forms of business entity which suited best to the nature and size of the business which the entrepreneur / business owner desires to undertake.

A business enterprise can be owned and organized in several forms. Each form of organization has its own merits and demerits. The ultimate choice of the form of business depends upon the balancing of the advantages and disadvantages of the various forms of business. The right choice of the form of the business is very crucial because it determines the power, control, risk and responsibility of the entrepreneur as well as the division of profits and losses. Being a long-term commitment, the choice of the form of business should be made after considerable thought and deliberation. The selection of a suitable form of business organization is an important entrepreneurial decision because it influences the success and growth of a business – e.g., it determines the division or distribution of profits, the risk associated with business, and so on.

Once a form of business organization is chosen, it is very difficult to switch over to another form because it needs the winding up, dissolution of the existing organization which may be treated as a case which is raised by one-self to face with the complex issues and procedures which ultimately results into the waste of time, effort and money. Further, closure of business will entail loss of business opportunity, capital and employment.

The volume of risks and liabilities as well as the willingness of the owners to bear it, is also an important consideration in choosing the right business entity.

Therefore, the form of business organization must be chosen after giving the due thought and consideration in respect of all the sides of the glorious coin of each form of business entity and its suitability to the business ideas of an entrepreneur. There are several factors to be considered while selecting an appropriate form of business organization.

As discussed earlier, the different forms of business organization differ from each other in respect of division of profit, control, risk, legal formalities, flexibility, etc. Therefore, a thoughtful consideration should be given to this aspect of planning and only that form of organization which most suited to the style of business should be chosen. Since the need for the selection of business organization arises both initially i.e., while starting a business, and at a later stage for meeting the needs of its growth and expansion, it is desirable to address this issue at both these levels.

## FACTORS GOVERNING THE DECISIONS FOR SUITABLE FORM OF ORGANIZATION

For a new or proposed business, the selection of a suitable form of a business organization is generally governed by the following factors:

- Nature of Business Activity
- Scale of Operations
- Capital Requirements

- Managerial Ability
- Degree of Control and Management
- Degree of Risk and Liability
- Stability of Business
- Flexibility of Administration
- Division of Profit
- Costs, Procedure and Government Regulation
- Tax Implication
- Geographical Mobility
- Transferability of Ownership
- Managerial Needs
- Secrecy
- Independence

**1. Nature of Business Activity**

This is an important factor having a direct bearing on the choice of a form of ownership.

In small trading businesses, professions, and rendering of personal services, sole-proprietorship is predominant. Examples are Laundromats, beauty parlors, repair shops, consulting agencies, small retail stores, medicine stores, dentist, accounting concerns, boarding-house, restaurants, specialty ships, jobbing builders, painters, decorators, bakers, confectioners, tailoring shops, small scale shoe repairers and manufacturers, etc.

The partnership is suitable in all those cases where sole proprietorship is suitable, provided the business is to be carried on a slightly bigger scale with help of one or more partner (owner).Besides, partnership is also advantageous in case of manufacturing activities on a modest scale. The finance, trading and real estate industries (on a smaller scale) seem to be suited to partnership form of organization.

Some of the financial businesses that find this form advantageous are tax, accounting, stockbrokerage firms, and consulting agencies etc.

Service enterprises like hotels and lodging places; trading enterprises, such as wholesale trade, retail houses; small scale manufacturing enterprises, small drug manufacturers, etc. can be undertaken in the form of partnership.

Similarly, the business lines such as carrying on large chain stores, multiple shops, super-bazaars, engineering, industrial activities with high capital and working capital requirements and software industrial activities are generally in the form of companies.

Where the persons intending to start a business wish to launch a business organization clothed with a legal entity and in corporate form with a feature of having their sole ownership and control thereon, they may decide to form a One-Person Company (OPC). OPC is a new concept in India and hybrid of Sole-Proprietor and Company form of business. The concept opens spectacular possibilities for sole proprietors and entrepreneurs as, such companies retain the character of a Sole Proprietorship, provides limited liability feature to the sole proprietor and is clothed with a legal entity distinct from its owner.

An alternative form of organization where two or more persons are involved in starting the business organization is the Limited Liability Partnership ('LLP') under the Limited Liability Partnership Act, 2008. Such entities have also gained popularity nowadays. A major advantage of such an entity is that the liabilities (if any), of the LLP lies with the entity and does not fall on the individual partners unlike the partnership form of business organization under the Indian Partnership Act, 1932, where the joint and several liabilities of the partner(s) is one of the features.

In an LLP form, the liability of the Partner is limited to the extent of his contribution towards the LLP, except in case of intentional fraud or wrongful act of omission or commission by the partner himself. What is at stake for the partner is what he has put into the business along with any personal guarantees he would have furnished.

However, such forms of business organization are suitable generally in the service industry and where there is no dependence on large amounts of financing from outside sources.

A One-Person Company (OPC), LLP and limited company exist as a separate business entity in the eyes of law and this creates a wall between the personal assets of the investor and that of the business. Thus, in these form of business organizations the personal property of the owner(s) is protected and this gives the owner(s) the ability to build the business credit, get loans and raise capital.

**2. Scale of Operations**

The second factor that affects the form of business organization is the scale of operations. If the scale of operations of business activities is small, sole proprietorship or a One Person Company (OPC) is suitable; if the scale of operations is modest - neither too small nor too large - partnership or limited liability partnership (LLP) is preferable; whereas, in case of large scale of operations, the company form is advantageous.

For instance, in accordance with the provision of Micro, Small & Medium Enterprises Development (MSMED) Act, 2006 the Micro, Small and Medium Enterprises (MSME) are classified as below:

As per Ministry of Micro, Small and Medium Enterprises- w.e.f. 1st July, 2020 an enterprise shall be classified as a micro, small or medium enterprise on the basis of the following criteria, namely:

i. a micro enterprise, where the investment in plant and machinery or equipment does not exceed one crore rupees and turnover does not exceed five crore rupees;

ii. a small enterprise, where the investment in plant and machinery or equipment does not exceed ten crore rupees and turnover does not exceed fifty crore rupees; and

iii. a medium enterprise, where the investment in plant and machinery or equipment does not exceed fifty crore rupees and turnover does not exceed two hundred and fifty crore rupees.

The scale of business operations depends upon the size of the market area served, which, in turn, depends upon the size of demand for goods and services. If the market area is small, local - sole-proprietorship, OPC or partnership is opted. If the demand originates from a large area- partnership including LLP or Company may be adopted.

**3. Capital Requirements**

Capital is one of the most crucial factors affecting the choice of a particular form of ownership organization. Requirement of capital is closely related to the type of business and scale of operations. Enterprises requiring heavy investment (like iron and steel plants, large scale infrastructure projects etc.) should be organized as companies. Depending on the capital required, they can be set up as public companies and, in some cases, may be in the form of listed companies by raising money from the public and being listed on the stock exchanges.

Enterprises requiring small investment (like retail business stores, personal service enterprises, etc.) can be best organized as sole proprietorships or even as Partnerships. Apart from the initial capital required to start a business, the future capital requirements - to meet modernization, expansion, and diversification plans - also affect the choice of form of organization.

In sole proprietorship, the owner may raise additional capital by borrowing, by purchasing on credit, and by investing additional amounts himself. Banks and suppliers, however, will look closely at the proprietor's individual financial resources before sanctioning any loans or advances.

Partnerships can often raise funds with greater ease, since the resources and credit of all partners are combined in a single enterprise. Companies are usually best able to attract capital because investors are assured that their liability will be limited, their operations are in public domain in the transparent manner, easily accessible and the ownership can be transferred to other investors.

**4. Managerial Ability**

It is difficult for a sole proprietor to have expertise in all functional areas of business. Further, the size of the business may not permit engagement of professional management.

In other forms of organizations like partnership and company, there is division of work among the partners which allows the partners to specialize in specific areas, leading to better outputs and decision making. However, this may sometimes lead to conflicts due to differences of opinion. Company form of organization is a better alternative if the operations are far flung, complex in nature and require professional management at various levels.

**5. Degree of Control and Management**

The degree of control and management that an entrepreneur desires to have over business affects the choice of form of organization.

In sole proprietorship and OPC: ownership, management, and control are completely fused, and therefore, an entrepreneur has complete control over his business.

In partnership: management and control of business is jointly shared by the partners and their specific rights, duties and responsibilities would be documented through incorporating various clauses in this regard in the partnership deed. They have equal voice in the management of partnership business except where they agree to divide among themselves the business responsibilities in a different manner. Even then, they are legally accountable to each other.

In a company: however, there is divergence between ownership and management, the management and control of the company business is entrusted to the Board, who are generally the elected representatives of shareholders.

Thus, a person wishing to have complete and direct control of business prefers proprietary organization rather than partnership or company. If he is prepared to share it with others, he will choose partnership. But, if the activities are large, professional managers are required to handle the day-to-day affairs and there is need for corporate structure and management, he will prefer the company form of organization.

**6. Degree of Risk and Liability**

The size of risk and the willingness of owners to bear it, is an important consideration in the selection of a form of business organization. The amount of risk involved in a business depends, among other factors like, on the nature and size of business. Smaller the size of business, smaller the amount of risk.

Thus, a sole proprietary business carries small amount of risk with it as compared to partnership or company. However, the sole proprietor is personally liable for all the debts of the business to the extent of his entire property. Likewise, in partnership, partners are individually and jointly responsible for the liabilities of the partnership firm.

Companies and LLPs have a real advantage, as far as the risk is concerned, over the other forms of business organization. Creditors can force payment of their claims only to the limit of the company's and LLPs assets. Thus, while a shareholder/member/partner may lose the entire money he puts into or agreed to put into the company and LLP, he cannot be forced to contribute additional funds out of his own pocket to satisfy the business debts of the company and LLP.

**7. Stability of Business**

Stability of business is another factor that governs the choice of an ownership organization. A stable business is preferred by the owners in so far as it helps him in attracting suppliers of capital who look for safety of investment and regular return, and also helps in getting competent workers and managers who look for security of service and opportunities of advancement. From this point of view, sole proprietorships are not stable, although no time limit is placed on them by law.

The illness of owner may derange the business and his death can lead to permanent closing off the business operations. Partnerships are also unstable, since they are terminated by the death, insolvency, insanity, retirement, admission, expulsion or withdrawal of/ by one of the partners. Companies and LLPs have the most business stability due to its feature or perpetuity being an artificial or legal person. The life of the company and LLP is not dependent upon the life of its members/partners. Members/partners may come,

members/partners may go, but the company/LLP goes on forever unless and until it being wound up.

**8. Flexibility of Administration**

As far as possible, the form of organization chosen should allow flexibility of administration. The flexibility of administration is closely related to the internal organization of a business, i.e., the manner in which organizational activities are structured into departments, sections, and units with a clear definition of authority and responsibility.

The internal functioning of a sole proprietary business, for instance, is very simple, and therefore, any change in its administration can be affected with least inconvenience and loss. To the large extent, the case is the same in a partnership business also.

While, in case of company, administration is not that flexible because its activities are conducted on a large scale and they are quite rigidly structured. Thus, in this form of structures any substantial change in the existing line of business activity- say from cotton textiles to sugar manufacturing may not be permitted by law if such a provision is not made in the 'objects clause' of the Memorandum of Association of the company.

Thus, from flexibility point of view, sole proprietorship has a distinct edge over other form.

**9. Division of Profit**

Profit is the guiding force of private business and it has a tremendous influence on the selection of a particular form of business organization. An entrepreneur desiring to pocket all the profits of business will naturally prefer sole proprietorship of course, in sole proprietorship, the personal liability is also unlimited.

But, if he is willing to share the profits, partnership form of organization would be preferred. In company form of organization, however, the profits (whenever the Board of Directors decides) are distributed among shareholders in proportion to their shareholding, but the liability of the shareholders is limited. The rate at which dividend is to be distributed is decided by the Board, though approved by the shareholders.

Companies may also reward shareholders by issue of bonus shares. In case of listed companies, the equity shares are tradable on the stock exchanges, enabling the shareholders to exit the company at any time as per their own discretion.

**10. Costs, Procedure and Government Regulation**

This is also an important factor that should be taken into account while choosing a particular form of organization.

Different forms of organization involve different procedure for establishment and are governed by different laws which affect the immediate and long-term functioning of a business enterprise. From this point of view, sole proprietorships are the easiest and cheapest to get started. There is no one specific government regulation but is guided by various state and central laws to give a valid proof of existence e.g. – Shops and Establishment Act. What is necessary is the technical competence and the business acumen of the owner and the requirement of meeting tax liabilities.

Partnerships are also quite simple to be initiated. Even a written document is not always necessarily a prerequisite since an oral agreement can be equally effective. However, in actual practice, written partnership deed is usually entered into, as it is needed for registration of the firm and for tax authorities. The procedure for dissolution of partnership is also, relatively simple.

Company form of business organization is more complicated to form. It can be created by law, dissolved by law, and operate under the express provisions of the law. In the formation of a company, a number of legal formalities have to be gone through which entails, at times, quite a substantial amount of expenditure. Further, various formalities have to be complied with for closure of companies. Non - payment of dues may land the ompany into insolvency or liquidation.

For example, the cost incurred on the drafting of the Memorandum of Association, the Articles of Association, the Prospectus, issuing of share capital, etc. can be quite high. This cost is however, small in case of private companies. Besides, companies are subjected to a large number of anti-monopoly and other economic laws so that they do not hamper the public interest.

11. **Tax Implication**

In the choice of the form of business organization, tax implication plays an important factor. In smaller entities, such as sole proprietorship or partnership, tax liability is dependent on the extent of profits. However, the liability of the owner(s) is unlimited. In case of companies or LLPs the liability of shareholders is limited to the value of shares they have purchased. In case of companies or LLPs, tax liability could be higher and charged at a flat rate.

12. **Geographical Mobility**

The extent to which the product or service is proposed to be manufactured or made available also plays a vital role in choosing the type of business organization. If a concern deals with local market, a seasonal product or perishable goods, or is meant to cater to a specific city or locality, then sole proprietorship or partnership form of business may be suitable. If it is proposed to market the product or service all over India (which may also entail providing customer support services), a company form of organization may be preferred.

13. **Transferability of Ownership**

Sole proprietorship, being a one-person entity does not lend itself to transferability of ownership as the owner himself enjoys the profits and suffers the losses in his business. Partnership form of organization is one where two or more partners share the profits and/or losses in the agreed proportion. If a partner exits, the partnership, may decide to induct a new partner with benefits of ownership and share of profits or losses. In the company form of organization, transfer of ownership is possible by transfer of shareholding by any person or group of persons in favor of another person or group of persons.

**14. Managerial Needs**

Managerial and administrative requirements also affect the decision about the form of organization. When the concern is small and it caters to local needs only then one person will be enough to manage the business. Sole– proprietorship form of organization will be suitable for such a business. If business caters to more areas, then more persons will be needed to look after various business functions in various areas. When a business is run on a large – scale basis, it will require the services of specialists to manage various departments. The company form of organization will be suitable for such concerns.

**15. Secrecy**

Secrecy is of supreme importance, particularly in small business concerns. Accordingly, the entrepreneur would select the sole proprietorship for that reason. In case, he has partners, he will have to carefully weigh whether other partners will be able to maintain the secrecy. He will have to exercise great care in taking partners. In case of a company, secrecy may be restricted to the manufacturing process or the manner in which business is conducted. However, certain aspects of their business such as their board of directors, shareholding, financial statements and other information which are statutorily required to be placed in public domain are accessible to any person.

**16. Independence**

The company is subject to strict government regulations. So, if the entrepreneur wants to have a freedom in business with little governmental interference, he has to go for either sole proprietorship or partnership.

## SYNOPSIS FOR CONSIDERATION OF FORM OF ORGANIZATION

The consideration of the various factors listed above clearly shows that:

**a.** These factors do not exist in isolation, but are interdependent, and all these factors are important in their own right. Nevertheless, the factors of nature of business and scale of operations are the most basic ones in the selection of a form of ownership for setting up of a business organization. All other factors are dependent on these basic considerations. For instance, the financial requirements of a business will depend on the nature of business and the scale of operations planned. To take an example, if a business wants to set up a trading enterprise (say, a retail store) on a small scale, his financial requirements will be small.

**b.** The various factors listed above are only major factors, and in no case, they constitute an exhaustive list. Depending upon the requirements of the business, the demands of the situation and sometimes even the personal preference of the owner, the choice of a form of ownership is made.

**c.** The problem in choosing the best form of business organization is one of the analyzing and weighing relative advantages and disadvantages to find the one that will yield the highest net advantage and for that, weights may be assigned to different factors depending upon their importance in each form of organization, and the type of organization that obtains the maximum weights may be ultimately selected.

## COMPANY AS A CHOICE OF BUSINESS ORGANIZATION FOR START-UPs

Start-ups prefer company as a business structure because it allows outside funding to be raised easily, limits the liabilities of its shareholders and enables them to offer employee stock options to attract top talent. As these entities must hold board meetings and file annual returns with the Ministry of Corporate Affairs (MCA), they tend to be viewed with more credibility than an LLP or General Partnership.

# Chapter 2 : Corporate Entities – Companies

## Introduction

The word "Company" is combination of the Latin word 'Cum' meaning "with or together" and "Panis" meaning "bread." Originally, it referred to a group of persons who took their meals together. A company is a group of persons who have come together or who have contributed money for some common purpose and who have incorporated themselves as a separate legal entity in the form of a company for that purpose. Under Halsbury's Laws of England, the term " company" has been defined as a collection of many individuals united into one body under special denomination, having perpetual succession under an artificial form and vested by the policies of law with the capacity of acting in several respect as an individual, particularly for taking and granting of property, for contracting obligation and for suing and being sued, for enjoying privileges and immunities in common and exercising a variety of political rights, more or less extensive, according to the design of its institution or the powers upon it, either at the time of its creation or at any subsequent period of its existence.

However, the Supreme Court of India has held in the case of State Trading Corporation of India vs. CTO that a company cannot have the status of a citizen under the Constitution of India.

A company as an entity has several distinct features which together make it a unique organization. The following are the defining characteristics of a company:

The Companies Act, 2013 provides for the kinds of companies that can be registered under the Act. The three basic types of companies which may be registered under the Act are:

**a)** Private Companies;

**b)** Public Companies; and

**c)** One Person Company (to be formed as a Private Limited Company).

Section 3 of the Companies Act 2013 read with the Companies (Incorporation) Rules, 2014, states that:

1) A company may be formed for any lawful purpose by–

   **a)** seven or more persons, where the company to be formed is a public company;

   **b)** two or more persons, where the company to be formed is a private company; or

   **c)** one person, where the company to be formed is a One Person Company that is to say, a private company,

   by subscribing their names or his name to a memorandum and complying with the requirements of the Act in respect of registration.

2) A company formed under sub-section (1) may be either–

   **a)** a company limited by shares; or

   **b)** a company limited by guarantee; or

   **c)** an unlimited company.

## Classification of Companies:

1) **Classification on the basis of Incorporation:** Companies may be incorporated under the following categories:

   a) **Statutory Companies:** Statutory Companies are constituted by a special Act of Parliament or State Legislature. The provisions of the Companies Act, 2013 do not apply to them. Examples of these types of companies are Reserve Bank of India, Life Insurance Corporation of India, etc.

   b) **Registered Companies:** The companies which are incorporated under the Companies Act, 2013 or under any previous company law and registered with the Registrar of Companies fall under the category of Registered Companies.

2) **Classification on the basis of Liability:** Companies can be classified into following three categories on the basis of Liability: -

   a) **Unlimited Companies:** The liability of members of this type of company is unlimited. Section 2(92) of the Companies Act, 2013 provides that unlimited company means a company not having any limit on the liability of its members. Such companies may or may not have share capital. They may be either a public company or a private company. The members are liable to the company and to any other person.

   b) **Companies limited by guarantee:** Section 2(21) of the Companies Act, 2013 provides that a company that has the liability of its members limited to such amount as the members may undertake respectively, by the Memorandum of Association, to contribute to the assets of the company in the event of its being wound-up, is known as a company limited by guarantee. The members of a guarantee company are placed in the position of guarantors of the company's debts up to the agreed amount. The members are liable to the company and to any other person upto the extent of guarantee given by them.

   c) **Companies limited by shares:** In this type of company, the liability of its members is limited by the liability clause in the Memorandum of Association to the amount, if any, unpaid on the shares respectively held by them. Section 2(22) of the Companies Act, 2013 provides that "company limited by shares" means a company having the liability of its members limited by the memorandum to the amount, if any, unpaid on the shares respectively held by them.

   For example, a shareholder who has paid Rupees 85 on a share of face value Rupees 100 can be called upon to pay the balance of Rupees.15 only. These companies can be either public or private.

3) **Other Forms of Companies:**

   a) **Section 8 Companies:** Any person or an association of persons proposed to be registered under this Act as a limited company and are able to prove to the satisfaction of the Central Government that the company –

      - has in its objects the promotion of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment or any such other object;

- intends to apply its profits, if any, or other income in promoting its objects; and
- intends to prohibit the payment of any dividend to its members,

such person or association of person may be allowed to be registered as a limited company without addition to its name of the word "limited" or "private limited" by the Central government by issuing a license under section 8 of the Companies Act and by prescribing the specified conditions. The association proposed to be registered under section 8 shall not be proposed to be an unlimited company. However, the same may be company limited by guarantee or a Company limited by shares.

**b) Foreign Companies:** As per section 2(42) of the Companies Act, 2013 the "foreign company" means any company or body corporate incorporated outside India which,-

- has a place of business in India whether by itself or through an agent, physically or through electronic mode; and
- Conducts any business activity in India in any other manner.

**c) Producer Companies:** Under Section 378A of the Companies Act, 2013, Producer Company means a body corporate having objects or activities specified in section 378B and registered as Producer Company under this Act or under the Companies Act, 1956.

**d) Nidhi:** A Nidhi is a type of company in the Indian non-banking financial sector, recognized under section 406 of the Companies Act, 2013. Their core business is borrowing and lending money only among their members. They are also known as Permanent Fund, Benefit Fund, Mutual Benefit Fund and Mutual Benefit Society. These companies are regulated under the Nidhi (Amendment) Rules, 2022 issued by the Ministry of Corporate affairs

**e) Listed Company:** "Listed company" means a company which has any of its securities listed on any recognized stock exchange.

**f) "Small company"** means a company, other than a public company,—

- paid-up share capital of which does not exceed four crore rupees, or such higher amount as may be prescribed which shall not be more than ten crore rupees; and
- turnover of which as per profit and loss account for the immediately preceding financial year does not exceed forty crore rupees or such higher amount as may be prescribed which shall not be more than one hundred crore rupees.

Provided that nothing in this clause shall apply to -

**a)** a holding company or a subsidiary company;

**b)** a company registered under section 8; or

**c)** a company or body corporate governed by any special Act.

## PRIVATE COMPANY

As per Section 2(68) of the Companies Act, 2013, "Private Company" means a company, which by its articles—

i. restricts the right to transfer its shares;

ii. except in case of One Person Company, limits the number of its members to two hundred:

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

Provided further that—

A. persons who are in the employment of the company; and

B. persons who, having been formerly in the employment of the company, were members of the company while in that employment and have continued to be members after the employment ceased, shall not be included in the number of members; and

iii. prohibits any invitation to the public to subscribe for any securities of the company.

It must be noted that it is only the number of members that is limited to two hundred. A private company may issue debentures to any number of persons, the only condition being that an invitation to the public to subscribe for debentures is prohibited.

The aforesaid definition of private limited company specifies the restrictions, limitations and prohibitions, which must be expressly provided in the articles of association of a private limited company.

As per proviso to Section 14 (1) of the Act, if a company being a private company alters its articles in such a manner that they no longer include the restrictions and limitations which are required to be included in the articles of a private company under this Act, such company shall, as from the date of such alteration, cease to be a private company.

The words 'Private Limited' must be added at the end of its name by a private limited company.

As per section 3(1), a private company may be formed for any lawful purpose by two or more persons, by subscribing their names to a memorandum and complying with the requirements of this Act in respect of registration. Section 149(1) further lays down that a private company shall have a minimum number of two directors. The only two members may also be the two directors of the private company.

## PUBLIC COMPANY

By virtue of Section 2(71), a public company means a company which is not a private company.

Provided that a company which is a subsidiary of a company, not being a private company, shall be deemed to be public company for the purposes of this Act even where such subsidiary company continues to be a private company in its articles.

As per section 3(1)(a), a public company may be formed for any lawful purpose by seven or more persons, by subscribing their names to a memorandum of association and complying with the requirements of this act in respect of registration.

A public company may be said to be an association consisting of not less than 7 members, which is registered under the Act. In principle, any member of the public who is willing to pay the price may acquire shares in or debentures of it. The securities of a public company may be quoted on a Stock Exchange. The number of members is not limited to two hundred.

As per section 58(2), the securities or other interest of any member in a public company shall be freely transferable. However, any contract or arrangement between two or more persons in respect of transfer of securities shall be enforceable as a contract.

The concept of free transferability of shares in public and private companies is discussed in the case of Western Maharashtra Development Corpn. Ltd. v. Bajaj Auto Ltd. [2010]. It was held that the Companies Act makes a clear distinction in regard to the transferability of shares relating to private and public companies. By definition, a "private company" is a company which restricts the right to transfer its shares. In the case of a public company, the Act provides that the shares or debentures and any interest therein, of a company, shall be freely transferable. The provision contained in the law for the free transferability of shares in a public company is founded on the principle that members of the public must have the freedom to purchase and every shareholder should have the freedom to transfer.

## ONE PERSON COMPANY

OPC is a one shareholder corporate entity, where legal and financial liability is limited to the company only. In India, in the year 2005, the J.J. Irani Expert Committee recommended the formation of OPC. It had suggested that such an entity may be provided with a simpler legal regime through exemptions so that the small entrepreneur is not compelled to devote considerable time, energy and resources on complex legal compliances.

**Characteristics of One Person Company**

1. The financial statement, with respect to One Person Company, may not include the cash flow statement.
2. The Memorandum of One Person Company shall indicate the name of the other person, with his prior written consent in the prescribed form, who shall, in the event of the subscriber's death or his incapacity to contract become the member of the company and the written consent of such person shall also be filed with the Registrar at the time of incorporation of the One Person Company along with its memorandum and articles.
3. The words "One Person Company" shall be mentioned in brackets below the name of such company, wherever its name is printed, affixed or engraved.
4. In relation to One Person Company, the annual return shall be signed by the company secretary, or where there is no company secretary, by the director of the company.
5. For the purposes of section 114, in respect of any business which is required to be transacted at an annual general meeting or other general meeting of a company by means of an ordinary or special resolution, it shall be sufficient if, in case of One Person Company, the resolution is communicated by the member to the company and entered in the minutes-book required to be maintained under section 118 and signed and dated by the member and such date shall be deemed to be the date of the meeting for all the purposes under this Act.

6. Notwithstanding anything in this Act, where there is only one director on the Board of Directors of a One Person Company, in respect of any business which is required to be transacted at the meeting of the Board of Directors of a company, it shall be sufficient, if, in case of such One Person Company, the resolution by such director is entered in the minutes-book required to be maintained under section 118 and signed and dated by such director and such date shall be deemed to be the date of the meeting of the Board of Directors for all the purposes under this Act. [sub section (4) of section 122}
7. The financial statement, shall be approved by the Board of Directors before they are signed on behalf of the Board by only one director, for submission to the auditor for his report thereon.
8. A One Person Company shall file a copy of the financial statements duly adopted by its member, along with all the documents which are required to be attached to such financial statements, within 180 days from the closure of the financial year.
9. A One Person Company, small company and dormant company shall be deemed to have complied with the provisions of this section if at least one meeting of the Board of Directors has been conducted in each half of a calendar year and the gap between the two meetings is not less than 90 days.

Provided that nothing contained in this sub-section and in section 174 shall apply to One Person Company in which there is only one director on its Board of Directors. [Section 173(5)].

## NIDHI

The primary objective of Nidhi is to carry on the business of accepting deposits and lending money to member borrowers only against jewels, etc., and mortgage of property. The principle of mutual benefit has been incorporated to pool the savings from members and lend only to members and they are prohibited from having dealing with non-members. Nidhis are not permitted to engage themselves in the business of chit fund, hire -purchase, insurance or in any other business including investments in shares or debentures. These Nidhis do their business only with members. Such members are only individuals. Bodies Corporate or Trusts are not to be admitted as members in these companies.

Nidhi means a company which has been incorporated as a Nidhi with the object of cultivating the habit of thrift and saving amongst its members, receiving deposits from, and lending to, its members only, for their mutual benefit, and which complies with the rules made by the central Government for regulation of such class of companies.

In exercise of powers conferred under section 406 read with section 469 of the Companies Act, 2013, Central Government issued the Nidhi Rules, 2014 which came into force on the 1st day of April, 2014. Nidhi Rules, 2014 are applicable to:

- every company which had been declared as a Nidhi or Mutual Benefit Society under sub-section (1) of Section 620A of the Companies Act, 1956;
- every company functioning on the lines of a Nidhi company or Mutual Benefit Society but has either not applied for or has applied for and is awaiting notification to be a Nidhi or Mutual Benefit Society under sub-Section (1) of Section 620A of the Companies Act, 1956;

- every company incorporated as a Nidhi pursuant to the provisions of Section 406 of the Companies Act, 2013;
- every company declared as Nidhi or Mutual Benefit Society under sub-section (1) of section 406 of the Companies Act, 2013.

**Characteristics of Nidhi**

- Every Nidhi shall be incorporated as a public company and shall have the last words "Nidhi Limited" as part of its name. It shall have a minimum paid up share capital of ten lakh rupees.
- Every Nidhi shall, within a period of 120 days from the date of its incorporation, file an application in form NDH-4 ensure that it has–
  - i. not less than two hundred members;
  - ii. Net Owned Funds of twenty lakh rupees or more.
- **Share capital and allotment:**
  - **a.** Every Nidhi shall issue fully paid up equity shares of the nominal value of not less than ten rupees each.
  - **b.** No service charge shall be levied for issue of shares.
  - **c.** Every Nidhi shall allot to each deposit holder at least a minimum of ten equity shares or shares equivalent to one hundred rupees.

  It may be noted that a savings account holder and a recurring deposit account holder shall hold at least one equity share of rupees ten.
- **Membership of Nidhi:**
  - **a.** A Nidhi shall not admit a body corporate or trust as a member.
  - **b.** Every Nidhi shall ensure that its membership is not reduced to less than two hundred members at any time.
  - **c.** A minor shall not be admitted as a member of Nidhi.
  - **d.** It may be noted that deposits may be accepted in the name of a minor, if they are made by the natural or legal guardian who is a member of Nidhi.
  - **e.** A member shall not transfer more than fifty percent of his shareholding during the subsistence of such loan or deposit, as the case may be; Provided that the member shall retain the minimum number of shares required under sub rule (3) of rule 7 at all times.
- **Branches of Nidhi:**
  - **a.** A Nidhi may open branches, only if it has earned net profits after tax continuously during the preceding 3 financial years. A Nidhi may open up to 3 branches within the district.
  - **b.** If a Nidhi proposes to open more than 3 branches within the district or any branch outside the district, it shall obtain the prior permission of the Regional Director in Form NDH-2 with fee and an intimation is to be given to the Registrar about opening of every branch within thirty days of such opening.

**c.** Nidhi shall not open branches outside the State where its registered office is situated.

**d.** Nidhi shall not open branches unless financial statement and annual return (up to date) are filed with the Registrar.

**e.** A Nidhi shall not close any branch unless –

i. the proposal to close the branch along with the plan as to how the existing deposits have been or shall be paid off and how the existing loan shall be recovered is duly approved by the board at its meeting;

ii. it has obtained the approval of the Regional Director for such closure by applying in Form NDH-2 with fee at least sixty days prior to such closure.

**f.** After obtaining the approval of the Regional Director, publishes an advertisement in a newspaper in vernacular language in the place where it carries on business at least thirty days prior to such closure, informing the public about such closure.

**g.** Fixes a copy of such advertisement or a notice informing such closure of the branch on the notice board of Nidhi for a period of at least thirty days from the date on which advertisement was published.

**h.** Gives an intimation to the Registrar within thirty days of such closure

- **Acceptance of deposits:**

Rule 13 of the Nidhi Rules, 2014 provides that

**a.** Fixed deposits accepted by a Nidhi shall be for a minimum period of 6 months and a maximum period of 60 months.

**b.** Recurring deposits shall be accepted for a minimum period of 12 months and a maximum period of 60 months. In case of recurring deposits relating to mortgage loans, the maximum period of recurring deposits shall correspond to the repayment period of such loans granted by Nidhi.

**c.** The maximum balance in a savings deposit account at any given time qualifying for interest shall not exceed one lakh rupees at any point of time and the rate of interest shall not exceed 2% above the rate of interest payable on savings bank account by nationalised banks.

**d.** A Nidhi may offer interest on fixed and recurring deposits at a rate not exceeding the maximum rate of interest prescribed by the Reserve Bank of India which the Non-Banking Financial Companies can pay on their public deposits.

- **Un-encumbered term deposits by Nidhi:**

Under Rule 14 of the Nidhi Rules, 2014, every Nidhi shall invest and continue to keep invested, in unencumbered term deposits with a Scheduled commercial bank (other than a co-operative bank or a regional rural bank), or post office deposits in its own name an amount which shall not be less than 10% of the deposits outstanding at the close of business on the last working day of the second preceding month.

In cases of unforeseen commitments, temporary withdrawal may be permitted with the prior approval of the Regional Director by making an application in Form NDH-2 for the purpose of repayment to depositors, subject to such conditions and time limit which may be specified by the Regional Director to ensure restoration of the prescribed limit of 10%.

- **Loans by Nidhi:**

  According to Rule 15 a Nidhi shall provide loans only to its members. In the case of joint holders, loan shall be provided to the member whose name appears first in the register of members. The loans given by a Nidhi to a member shall be subject to the following limits, namely:-

  **a.** two lakh rupees, where the total amount of deposits of such Nidhi from its members is less than two crore rupees;

  **b.** seven lakh fifty thousand rupees, where the total amount of deposits of such Nidhi from its members is more than two crore rupees but less than twenty crore rupees;

  **c.** twelve lakh rupees, where the total amount of deposits of such Nidhi from its members is more than twenty crore rupees but less than fifty crore rupees; and

  **d.** fifteen lakh rupees, where the total amount of deposits of such Nidhi from its members is more than fifty crore rupees.

  Where a Nidhi has not made profits continuously in the three preceding financial years, it shall not make any fresh loans exceeding fifty per cent of the maximum amounts of loans specified in clauses (a), (b), (c) or (d).

  A member shall not be eligible for any further loan if he has borrowed any earlier loan from the Nidhi and has defaulted in repayment of such loan.

- **Rate of interest on any loan given by a Nidhi:**

  The rate of interest to be charged on any loan given by a Nidhi shall not exceed seven and half percent above the highest rate of interest offered on deposits by Nidhi and shall be calculated on reducing balance method. Nidhi shall charge the same rate of interest on the borrowers in respect of the same class of loans and the rate of interest of all classes of loans shall be prominently displayed on the notice board at the registered office and each branch office of Nidhi.

- **Directors in a Nidhi:**

  The Director shall be a member of the Nidhi. The Director of a Nidhi shall hold office for a term up to 10 consecutive years on the Board of the Nidhi. The Director shall be eligible for re-appointment only after the expiration of two years of ceasing to be a Director. Where the tenure of any Director in any case had already been extended by the Central Government, it shall terminate on expiry of such extended tenure. The person to be appointed as a Director shall comply with the requirements of Director Identification Number. All the directors of the company shall fulfill the fit and proper person criteria.

- **Dividend:**

  A Nidhi shall not declare dividend exceeding 25% in a financial year.

## SECTION 8 COMPANY

Section 8 company is a company established for promoting commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment or any such other object, provided the profits, if any, or other income is applied for promoting only the objects of the company and no dividend is paid to its members Section 8 Companies are registered under the Companies Act, 2013.

Section 8 of the Companies Act, 2013 reads as under:

1. Where it is proved to the satisfaction of the Central Government that a person or an association of persons proposed to be registered under this Act as a limited company—
   a. has in its objects the promotion of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment or any such other object;
   b. intends to apply its profits, if any, or other income in promoting its objects; and
   c. intends to prohibit the payment of any dividend to its members, the Central Government may, by licence issued in such manner as may be prescribed, and on such conditions as it deems fit, allow that person or association of persons to be registered as a limited company under this section without the addition to its name of the word "Limited", or as the case may be, the words "Private Limited", and thereupon the Registrar shall, on application, in the prescribed form, register such person or association of persons as a company under this section.
2. The company registered under this section shall enjoy all the privileges and be subject to all the obligations of limited companies.
3. A firm may be a member of the company registered under this section.
4.
   i. A company registered under this section shall not alter the provisions of its memorandum or articles except with the previous approval of the Central Government.
   ii. A company registered under this section may convert itself into company of any other kind only after complying with such conditions as may be prescribed.
5. Where it is proved to the satisfaction of the Central Government that a limited company registered under this Act or under any previous company law has been formed with any of the objects specified in clause (a) of sub-section (1) and with the restrictions and prohibitions as mentioned respectively in clauses (b) and (c) of that sub-section, it may, by licence, allow the company to be registered under this section subject to such conditions as the Central Government deems fit and to change its name by omitting the word "Limited", or as the case may be, the words "Private Limited" from its name and thereupon the Registrar shall, on application, in the prescribed form, register such company under this section and all the provisions of this section shall apply to that company.

6. The Central Government may, by order, revoke the licence granted to a company registered under this section if the company contravenes any of the requirements of this section or any of the conditions subject to which a licence is issued or the affairs of the company are conducted fraudulently or in a manner violative of the objects of the company or prejudicial to public interest, and without prejudice to any other action against the company under this Act, direct the company to convert its status and change its name to add the word "Limited" or the words "Private Limited", as the case may be, to its name and thereupon the Registrar shall, without prejudice to any action that may be taken under subsection (7), on application, in the prescribed form, register the company accordingly.

   Provided that no such order shall be made unless the company is given a reasonable opportunity of being heard. Provided further that a copy of every such order shall be given to the Registrar.

7. Where a licence is revoked under sub-section (6), the Central Government may, by order, if it is satisfied that it is essential in the public interest, direct that the company be wound up under this Act or amalgamated with another company registered under this section.

   Provided that no such order shall be made unless the company is given a reasonable opportunity of being heard.

8. Where a licence is revoked under sub-section (6) and where the Central Government is satisfied that it is essential in the public interest that the company registered under this section should be amalgamated with another company registered under this section and having similar objects, then, notwithstanding anything to the contrary contained in this Act, the Central Government may, by order, provide for such amalgamation to form a single company with such constitution, properties, powers, rights, interest, authorities and privileges and with such liabilities, duties and obligations as may be specified in the order.

9. If on the winding up or dissolution of a company registered under this section, there remains, after the satisfaction of its debts and liabilities, any asset, they may be transferred to another company registered under this section and having similar objects, subject to such conditions as the Tribunal may impose, or may be sold and proceeds thereof credited to "Insolvency and Bankruptcy Fund formed under section 224 of the Insolvency and Bankruptcy Code, 2016".

10. A company registered under this section shall amalgamate only with another company registered under this section and having similar objects.

11. If a company makes any default in complying with any of the requirements laid down in this section, the company shall, without prejudice to any other action under the provisions of this section, be punishable with fine which shall not be less than ten lakh rupees but which may extend to one crore rupees and the directors and every officer of the company who is in default shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to twenty-five lakh rupees.

### Characteristics of Section 8 Company

Certain features of a Section 8 company can be summarized as under:

1. It is formed for promoting commerce, art, science, sports, education, research, social welfare, religion, Charity, protection of environment or any such other object.
2. The profits, if any, are applied in promoting its objects.
3. It prohibits the payment of dividends to its members.
4. The Company can be incorporated without using the word "Limited" or "Private Limited" as the case may be.
5. There is no requirement of any minimum paid up capital.
6. It is exempted from stamp duty registration.
7. A One Person Company cannot be incorporated or converted into a Section 8 Company.
8. Section 8 company has its independent corporate legal entity, similar to private company, public company or a Limited Liability Partnership and hence enjoys credibility in the eyes of the public.

## PRODUCER COMPANY

Chapter XXIA (Section 378 A to 378 ZU) of Companies Act, 2013 deals with the producer companies. A producer company is a body corporate having objects or activities specified in Section 378B of Companies Act, 2013 and which is registered as such under the provisions of this Act or the Companies Act, 1956. The membership of producer companies is open to such people who themselves are the primary producers, which is an activity by which some agricultural produce is produced by such primary producers.

### Objects of Producer Companies

In terms of Section 378B of the Companies Act, 2013, the objects of a producer company registered under this Act may be all or any of the following matters:

a. production, harvesting, procurement, grading, pooling, handling, marketing, selling, export of primary produce of the Members or import of goods or services for their benefit: Provided that the Producer Company may carry on any of the activities specified in this clause either by itself or through other institution;
b. processing including preserving, drying, distilling, brewing, vinting, canning and packaging of produce of its Members;
c. manufacture, sale or supply of machinery, equipment or consumables mainly to its Members;
d. providing education on the mutual assistance principles to its Members and others;
e. rendering technical services, consultancy services, training, research and development and all other activities for the promotion of the interests of its Members;
f. generation, transmission and distribution of power, revitalisation of land and water resources, their use, conservation and communications relatable to primary produce;
g. insurance of producers or their primary produce;
h. promoting techniques of mutuality and mutual assistance;

i. welfare measures or facilities for the benefit of Members as may be decided by the Board;

j. any other activity, ancillary or incidental to any of the activities referred to in clauses (a) to (i) or other activities which may promote the principles of mutuality and mutual assistance amongst the Members in any other manner;

k. Financing of procurement, processing, marketing or other activities specified in clauses (a) to (j) which include extending of credit facilities or any other financial services to its Members.

Every Producer Company shall deal primarily with the produce of its active Members for carrying out any of its objects specified in this section

## FOREIGN COMPANY

As per section 2(42), "foreign company" means any company or body corporate incorporated outside India which –

(a) has a place of business in India whether by itself or through an agent, physically or through electronic mode; and

(b) Conducts any business activity in India in any other manner.

Sections 379 to 393 under Chapter XXII of the Act deal with such companies.

Section 380 of the Act lays down that every foreign company which establishes a place of business in India must, within 30 days of the establishment of such place of business, file with the Registrar of Companies for registration:

i. a certified copy of the charter, statutes or memorandum and articles, of the company or other instrument constituting or defining the constitution of the company and, if the instrument is not in the English language, a certified translation thereof in the English language;

ii. the full address of the registered or principal office of the company;

iii. a list of the directors and secretary of the company containing such particulars as may be prescribed;

iv. the name and address or the names and addresses of one or more persons resident in India authorised to accept on behalf of the company service of process and any notices or other documents required to be served on the company;

v. the full address of the office of the company in India which is deemed to be its principal place of business in India;

vi. particulars of opening and closing of a place of business in India on earlier occasion or occasions;

vii. declaration that none of the directors of the company or the authorised representative in India has ever been convicted or debarred from formation of companies and management in India or abroad; and

viii. Any other information as may be prescribed.

Every foreign company has to ensure that the name of the company, the country of incorporation, the fact of limited liability of members is exhibited in the specified places or documents as required under Section 382 of the Act.

Section 376 of the Companies Act, 2013 provides further that when a foreign company, which has been carrying on business in India, ceases to carry on such business in India, it may be wound up as an unregistered company under Sections 375 to 378 of the Act, even though the company has been dissolved or ceased to exist under the laws of the country in which it was incorporated.

Section 379 provides that where not less than 50% of the paid-up share capital, whether equity or preference or partly equity and partly preference of a foreign company is held by one or more citizens of India or by one or more bodies corporate incorporated in India, whether singly or in the aggregate, such company shall comply with such of the provisions of this Act, as may be prescribed by the Central Government with regard to the business carried on by it in India, as if it were a company incorporated in India.

Section 381 requires a Foreign Company to maintain books of Account and file a copy of balance sheet and profit and loss account in prescribed form with ROC every calendar year. These accounts should be accompanied by list of places of business established by the foreign company in India as at the date with reference to which the balance sheet is made out.

As regards the applicability of the provisions of the Companies Act, 2013 to foreign companies, the following provisions of section 384 are to be noted:

i. The provisions of section 71 relating to Debentures shall apply mutatis mutandis to a foreign company.

ii. The provisions of Section 92 regarding (filing of annual returns) and Section 135 (Corporate Social Responsibility) shall, subject to such exceptions, modifications or adaptations as may be made therein by the rules made under the Act, apply to a foreign company as they apply to a company incorporated in India.

iii. The provisions of Section 128 shall apply to a foreign company to the extent of requiring it to maintain at its principal place of business in India books of account with respect to moneys received and spent, sales and purchase made and assets and liabilities, in the course of or in relation to its business in India.

iv. The provisions of Chapter VI (Registration of Charges) shall apply mutatis mutandis to charges on properties which are created or acquired by any foreign company.

v. The provisions of Chapter XIV (Inspection, Inquiry and Investigation) shall apply mutatis mutandis to the Indian business of a foreign company as they apply to a company incorporated in India.

As per Section 386(c), having a share transfer office or registration office will constitute a place of business. In Tovarishestvo Manufacture Liudvig Rabenek, Re [1944] it was held that where representatives of a company incorporated outside the country frequently stayed in a hotel in England for looking after matter of business, it was held that the company had a place of business in England.

# MEMORANDUM OF ASSOCIATION

The Memorandum of Association is a document which sets out the constitution of a company and is therefore the foundation on which the structure of the company is built. It defines the scope of the company's activities and its relations with the outside world.

The first step in the formation of a company is to prepare a document called the memorandum of association. In fact, memorandum is one of the most essential pre-requisites for incorporating any form of company under the Companies Act, 2013 (hereinafter referred to as 'Act'). This is evidenced in Section 3 of the Act, which provides the mode of incorporation of a company and states that a company may be formed for any lawful purpose by seven or more persons, where the company to be formed is a public company; two or more persons, where the company to be formed is a private company; or one person, where the company to be formed is a One Person Company by subscribing their names or his name to a memorandum and complying with the requirements of this Act in respect of its registration.

To subscribe means to append one's signature or mark in a document as an approval or attestation of its contents.

According to Section 2(56) of the Act "memorandum" means the memorandum of association of a company as originally framed and altered, from time to time, in pursuance of any previous company law or this Act.

Section 4 of the Act specifies in clear terms the contents of this important document which is the charter of the company. The memorandum of association of a company contains the objects of the company which it shall pursue. It not only shows the objects of formation of the company but also determines the scope of its operations beyond which its actions cannot go.

## Forms of Memorandum of Association

Section 4(6) of the Act provides that the memorandum of association should be in any one of the Forms specified in Tables A, B, C, D or E of Schedule I to the Act, as may be applicable in relation to the type of company proposed to be incorporated or in a Form as near thereto as the circumstances admit.

**a)** the Form in Table A is applicable in the case of companies limited by shares;

**b)** the Form in Table B is applicable to companies limited by guarantee not having a share capital;

**c)** the Form in Table C is applicable to the companies limited by guarantee having a share capital;

**d)** the Form in Table D is applicable to unlimited companies not having a share capital;

**e)** The Form in Table E is applicable to unlimited companies having a share capital.

A company shall adopt any of the model Forms of the memorandum of association mentioned above, as may be applicable to it.

## Contents of Memorandum of Association

As per Section 4, the memorandum of a limited company must state the following:

- **Name Clause :** The name of the company with "Limited" as its last word in the case of a public company; and "Private Limited" as its last words in the case of a private company. This shall not apply in case of companies registered under section 8.

  Similarly, in case of government companies the name of the company need not end with the words "Limited" or "Private Limited". This is as per the exemptions to Government Companies under Section 462 of Companies Act, 2013 vide notification dated June 5, 2015.

  According to section 4(2), the name stated in the memorandum shall not –

  a. be identical with or resemble too nearly to the name of an existing company registered under this Act or any previous company law; or

  b. be such that its use by the company –

  (i) will constitute an offence under any law for the time being in force; or

  (ii) is undesirable in the opinion of the Central Government.

### Identical Names

Rule 8 of the Companies (incorporation) Rules, 2014, provides that before granting any name, it will be examined whether name is identical with name of any other company/LLP or any other name already allowed to a company/LLP. To determine whether a proposed name is identical with another, the differences which are arising on account of the following are to be disregarded:

**a)** the words like Private, Pvt, Pvt., (P), OPC Pvt. Ltd., IFSC Limited, IFSC Pvt. Limited, Producer Limited, Limited, Unlimited, Ltd, Ltd., LLP, Limited Liability Partnership, company, and company, & co, & co., co., co, corporation, corp, corpn, corp or group;

**b)** the plural or singular form of words in one or both names;

**Illustrations**

(i) Green Technology Ltd. is same as Greens Technology Ltd. and Greens Technologies Ltd.

(ii) SM Computers Ltd. is not same as SMS Computers Ltd.

**c)** type and case of letters, spacing between letters, punctuation marks and special characters used in one or both names;

**Illustration**

ABC Ltd. is same as A.B.C. Ltd. and A B C Ltd.

**d)** use of different tenses in one or both names;

**Illustration**

Ascend Solutions Ltd. is same as Ascended Solutions Ltd. and Ascending Solutions Ltd.

**e)** use of different phonetic spellings including use of misspelled words of an expression;

**Illustration**

Chemtech Ltd. is same as Chemtec Ltd., Chemtek Ltd., Cemtech Ltd., Cemtek Ltd., Kemtech Ltd., and Kemtek Ltd

**f)** use of host name such as 'www' or a domain extension such as 'net', 'org', 'dot' or 'com' in one or both names;

**Illustration**

Ultra Solutions Ltd. is same as Ultrasolutions.com Ltd.

**g)** the order of words in the names;

**Illustration**

Ravi Builders and Contractors Ltd. is same as Ravi Contractors and Builders Ltd.

**h)** use of the definite or indefinite article in one or both names;

**Illustration**

Congenial Tours Ltd. is same as A Congenial Tours Ltd. and The Congenial Tours Ltd.

**i)** a slight variation in the spelling of the two names including a grammatical variation thereof;

**Illustration**

Color Technologies Ltd. is same as Colour Technologies Ltd.

**j)** complete translation or transliteration, and not part thereof, of an existing name, in Hindi or in English;

**Illustration**

National Electricity Corporation Ltd. is same as Rashtriya Vidyut Nigam Ltd.

**k)** addition of the name of a place to an existing name, which does not contain the name of any place;

**Illustration**

If Salvage Technologies Ltd. is an existing name, it is same as Salvage Technologies Delhi Ltd and Salvage Delhi Technologies Ltd.

**l)** addition, deletion, or modification of numerals or expressions denoting numerals in an existing name, unless the numeral represents any brand;

**Illustration**

Thunder Services Ltd is same as Thunder11 Services Ltd and OneThunder Services Ltd.

## Undesirable Names

Rule 8A of the Companies (incorporation) Rules, 2014, provides that the Undesirable names are those names which in the opinion of the Central Government are:

1. Prohibited under the Provisions of Section 3 of Emblems and Names (Prevention and Improper Use) Act, 1950.
2. The name includes a trade mark registered under the Trade Marks Act, 1999.
3. Name is identical with or too nearly resembles the name of a limited liability partnership.
4. The name includes any word or words which are offensive to a section of people.
5. The proposed name contains the words 'British India'.
6. The proposed name includes the word "State", in case the company is not a Government company.
7. The proposed name is containing only the name of a continent, country, State, city such as Asia limited, Germany Limited, Haryana Limited or Mysore Limited.

**Word or expression which can be used only after obtaining previous approval of Central Government**

Rule 8B of the Companies (incorporation) Rules, 2014, provides that, the following words and combinations thereof shall not be used in the name of a company in English or any of the languages depicting the same meaning unless the previous approval of the Central Government has been obtained for the use of any such word or expression:-

- Board
- Commission
- Authority
- Undertaking
- National
- Union
- Central
- Federal
- Republic
- President
- Rashtrapati
- Small Scale Industries
- Khadi and Village Industries Corporation
- Financial Corporation and the like
- Municipal
- Panchayat
- Development Authority
- Prime Minister or Chief Minister
- Minister
- Nation

- Forest corporation
- Development Scheme
- Statute or Statutory
- Court or Judiciary
- Governor
- the use of word Scheme with the name of Government (s), State, India, Bharat or any Government authority or in any manner resembling with the schemes launched by Central, State or local Governments and authorities
- Bureau.

## Precautions to be taken care before applying for the proposed name

One should be very careful while applying for the name, there can be rejection of name approval application in the following cases:

**a)** Proposed Name exactly identical/resembled/phonetically to the name of an existing company/LLP.

**b)** Proposed Name includes words which are registered under Trademark Act with a specific class(es).

**c)** Wrong Class/Category/Sub-Category of the Proposed Company is mentioned in web form.

**d)** Industrial Activity Code of NIC is not found in consonance with the attached objects of the Company in SPICe+ PART A.

**e)** Proposed Name is found Descriptive i.e. it contains commonly used words. (proper pre- fix or suffix not used in name)

**f)** No significance about Abbreviations used in proposed name.

**g)** Proposed Name indicates words Finance/Investment/Capital/ Holding/ Insurance etc whereas the proposed objects of the Company do not indicate such activities.

**h)** Objects mentioned in the form are vague and the TM cannot be ascertained. (E.g. manufacturing / development / producing of all type of goods etc.)

**i)** Name contain words viz Board, National, Commission etc as given in Rule 8B of the Companies (Incorporation) Rules, 2014 for which previous approval of the Central Government is required.

**j)** Application made with Restricted and Undesirable names. (System may not allow filing of such applications)

**k)** Proposed name if resembles closely the popular or abbreviated description of an existing company or limited liability as per rule 8A(1)(h) of Companies (Incorporation) Fifth Amendment Rules, 2019.

**l)** Previous approval of the Central Government has not been obtained and attached with application Where any word or expression which is likely to give the impression that the company is in any way connected with, or having the patronage of, the

Government, or any local authority, corporation or body constituted by the any Government.

**m)** If the proposed name contains the name a foreign country/city/town etc. then applicant has to attach any proof of significance of business relations with such foreign country like MOU with a company of such country. In case proposed name includes name of India and a foreign country (e.g. India Japan or Japan India) in such cases name shall be allowed if, there is Government to government participation or patronage and no company shall be incorporated using the name of enemy country.

## Reservation of Name

As per section 4(4) a person may make an application, in web-based service SPICe+ (Simplified Proforma for Incorporating Company Electronically Plus: INC-32) and for change of name by web service RUN (Reserve Unique Name)form in prescribed manner and accompanied by prescribed fee to the Registrar for the reservation of a name set out in the application as –

(a) The name of the proposed company; or

(b) The name to which the company proposes to change its name.

## Reservation of Name for 20 days

Section 4(5) (i) lays down that upon receipt of an application under sub-section (4), the Registrar may, on the basis of information and documents furnished along with the application, reserve the name for a period of 20 days from the date of approval.

In case of an application for reservation of name or for change of its name by an existing company, the Registrar may reserve the name for a period of sixty days from the date of approval.

## Common reasons for rejection of name:

- Proposed name is not according to the activities described in Main Objects.
- Proposed Name is not available in view of the existence of identical or closely resembling companies.
- Proposed name is too general without any distinct word or identity.
- Keywords like Industry/ Udyog, Enterprises, Products, Business, manufacturing may be considered when the company proposes to deal in various business activities. In case business activity is in particular trade said keywords cannot be allowed.
- Words like International, Hindustan, India, Bharat, Continental, Asiatic, Corporation will not be allowed unless the scope and scale of business of the proposed company justify the use of words.
- Proposed name includes words like National, Central, Union, Federal etc which are considered as undesirable.

Section 4(5)(ii) provides that giving wrong or incorrect name information in the name reservation application is wrong and if it is found that name was applied by furnishing wrong or incorrect information, then the reserved name shall be cancelled and the

person making name reservation application shall be liable to a penalty which may extend to one lakh rupees.

Further, if the company has been incorporated, the Registrar may, after giving the company an opportunity of being heard—

- either direct the company to change its name within a period of three months, after passing an ordinary resolution;
- take action for striking off the name of the company from the register of companies; or
- make a petition for winding up of the company.

- **Situation Clause:** The name of the State in which the registered office of the company is to be situated must be given in the memorandum. But the exact address of the registered office is not required to be stated therein. According to section 12 of the Act within thirty (30) days of company's incorporation, and at all times thereafter, the company must have a registered office to which all communications and notices may be sent.

**Verification of registered office:** The Company must also furnish to the Registrar verification of its registered office within a period of 30 days of its incorporation in such manner as may be prescribed (e-form INC-22). However, it may be noted that e-Form INC 22 is not required to be filed with SPICe+, if a company is registered with the same address as the address for correspondence. In case the registered address is different, INC-22 is required to be filed within 30 days of its incorporation, for intimating the registered office address.

**Obligation of the company regarding the registered office:** According to Section 12(3) of the Act, every company is required to display its name and address in legible letters in conspicuous position and in all its business letters, bill heads, and letter papers. Accordingly, the company shall –

**a.** paint or affix its name, and the address of its registered office, and keep the same painted or affixed, on the outside of every office or place in which its business is carried on, in a conspicuous position, in legible letters, and if the characters employed therefor are not those of the language or of one of the languages in general use in that locality, also in the characters of that language or of one of those languages;

**b.** have its name engraved in legible characters on its seal, if any;

**c.** get its name, address of its registered office and the Corporate Identity Number along with telephone number, fax number, if any, e-mail and website addresses, if any, printed in all its business letters, billheads, letter papers and in all its notices and other official publications;

**d.** have its name printed on negotiable instruments such as hundies, promissory notes, bills of exchange and such other document as may be prescribed;

**e.** If it has a website for conducting online business or otherwise, shall disclose/publish its name, address of its registered office, the CIN, Telephone

number, fax number if any, email and the name of the person who may be contacted in case of any queries or grievances on the landing/home page of the said website.

However, where a company has changed its name or names during the last two years, it shall paint or affix or print, as the case may be, along with its name, the former name or names so changed during the last two years.

Further, in case of One Person Company, the words "One Person Company" shall be mentioned in brackets below the name of such company, wherever its name is printed, affixed or engraved.

- **Object Clause:** The third compulsory clause in the memorandum sets out the objects for which the company has been formed. Under section 4(1) (c) of the Act, all companies must state in their memorandum the objects for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof. It indicates the purpose for which the company has been set up and its actual capability, besides its sphere of activities. It states affirmatively the ambit and extent of powers of the company and, stated negatively, that nothing should be done beyond that ambit and that no attempt shall be made to use the company for any other purpose than that which is specified. The purpose of the object clause is to enable the persons dealing with the company to know its permitted range of activities. The acts beyond this ambit are ultra vires and hence void. Even the entire body of shareholders cannot ratify such acts. The subscribers to the memorandum of association enjoy almost unrestricted freedom to choose the objects. The only restriction is that objects should not be illegal and against the provisions of the Companies Act, 2013.

  The objects are divided into two sub-categories:

  - Main Objects;
  - Any matter considered necessary in furtherance thereof.

  The main objects of the MOA give a brief about the activities that are decided to be carried by the company. The main objects of the company generally include the activities like manufacturing, trading or providing any kind of services by the company. Further, another sub clause (any matter considered necessary in furtherance thereof) describes the activities incidental to the main objects. Also, it can contain the activities related to the business keeping in mind the diversification needs of future and to avoid alteration in future.

- **Liability Clause:** The liability of members of the company, whether limited or unlimited, and also state: -

  - in the case of a company limited by shares, that liability of its members is limited to the amount unpaid, if any, on the shares held by them; and
  - in the case of a company limited by guarantee, the amount up to which each member undertakes to contribute –

**A.** to the assets of the company in the event of its being wound-up while he is a member or within one year after he ceases to be a member, for payment of the debts and liabilities of the company or of such debts and liabilities as may have been contracted before he ceases to be a member, as the case may be; and

**B.** to the costs, charges and expenses of winding-up and for adjustment of the rights of the contributories among themselves.

**For Example:**

In the MOA of Tata Consultancy Services Limited, it is provided that a Company Limited by Shares.

The Liability Clause illustrates the kind of liabilities one may have if he became a member of a company. Here are some essential categories of the Liability clause:

1) **Limited by Shares:** The first type is Liability limited by shares. In the case of a company whose Liability is limited by shares, the Liability of the members in case the company goes for winding up is limited by the number of shares that have been purchased and to the extend unpaid by the members.

2) **Limited by Guarantee:** The second kind is Liability limited by Guarantee. In this case, every member beforehand guarantees a certain amount that they will pay in case the company moves for winding up.

3) **Unlimited Liability:** In the case of an unlimited company, every member of the company is liable to pay for an unlimited amount if the company moves for winding up. The liability of members can be for an amount as large as can be and extends to members' personal property as well.

- **Capital Clause:** in the case of a company having a share capital, the amount of share capital with which the company is to be registered and the division thereof into shares of a fixed amount. This clause shall state the amount of the capital with which the company is registered. The shares into which the capital is divided must be of fixed value, which is commonly known as the nominal value of the share.

  The capital is variously described as "nominal", "authorized" or "registered". The amount of nominal capital is determined having regard to the present as well as future requirements of the company with reference to its objects.

  The usual way to state the capital in the memorandum is: "The share capital of the company is 10,00,000 rupees divided into 1, 00,000 equity shares of 10 rupees each". This amount lays down the maximum limit beyond which the company cannot issue shares without altering the memorandum as provided by Section 61 of the Companies Act, 2013.

  If there are both equity and preference shares, then the division of the capital is to be shown under these two heads. A company is not authorized to issue capital beyond its authorized/nominal/registered capital. If it receives applications for shares beyond the shares covered by the authorized capital, the amount received on excess number of shares should be returned.

Out of the issued capital, the total amount actually subscribed or agreed to be subscribed is known as subscribed capital, and this subscribed capital again may be wholly paid or partly paid, in which latter case the balance would be payable on future calls when made. The amount actually paid by the shareholders is called the paid- up capital.

- **Subscription Clause:**
  - the number of shares which the subscribers to the memorandum agree to subscribe which shall not be less than one share; and
  - the number of shares each subscriber to the memorandum intends to take, indicated opposite his name.

In the case of a One Person Company, the name of the person who, in the event of the death of the subscriber, shall become the member of the company.

The subscriber sheet to the Memorandum of Association is a vital document that is required to be submitted along with the Memorandum of Association during the company registration process. It provides the details of the first members of the company.

The required details include:

- The name of the subscribers.
- The details of the father or spouse of the subscribers.
- The complete address of the subscribers with a valid pin code.
- The pan card number and occupation of the subscribers.
- Signatures of the subscribers.
- The subscription sheet needs to mention the total number of shares that have been subscribed to by each subscriber.
- If a subscriber is a Company or corporate body, its director or partner's signature on behalf of the company.
- The witness authenticates details of the subscriber sheet.

**Provision in the memorandum or articles is void**

According to section 4(7), any provision in the memorandum or articles, in the case of a company limited by guarantee and not having a share capital, purporting to give any person a right to participate in the divisible profits of the company otherwise than as a member, shall be void.

The above clauses are compulsory and are designated as "conditions" prescribed by the Act, on the basis of which a company is incorporated.

It is to be noted that the Companies Act, 2013 shall override the provisions in the memorandum articles, agreement or resolution of a company, if the latter contains anything contrary to the provisions in the Act (Section 6).

## ARTICLES OF ASSOCIATION

According to Section 2(5) of the Companies Act, 2013, 'articles' means the articles of association of a company as originally framed or as altered from time to time or applied in pursuance of any previous company law or of this Act. It also includes the regulations contained in Table A in Schedule I of the Act, in so far as they apply to the company. In case of a private company, the provisions of Table A may be altered to suit the specific requirements of the company, provided that any such alteration should not be contrary to the provisions of the Companies Act, 2013.

The general functions of the articles have been aptly summed up by Lord Cairns, L.C. in Ashbury Railway Carriage and Iron Co. Ltd. v. Riche, (1875) L.R. 7 H.L. 653 as follows:

"The articles play a part that is subsidiary to the memorandum of association. They accept the memorandum of association as the charter of incorporation of the company, and so accepting it, the articles proceed to define the duties, rights and powers of the governing body as between themselves and the company at large, and the mode and form in which business of the company is to be carried on, and the mode and form in which changes in the internal regulations of the company may from time to time be made... The memorandum, is as it were... the area beyond which the action of the company cannot go; inside that area shareholders may make such regulations for the governance of the company as they think fit".

Thus, the memorandum lays down the scope and powers of the company, and the articles govern the ways in which the objects of the company are to be carried out and can be framed and altered by the members. But they must keep within the limits marked out by the memorandum and the Companies Act.

The articles of a company are subordinate to and subject to the memorandum of association and the Act. Any clause in the Articles going beyond the memorandum will be ultra vires. But the articles are only internal regulations, over which the members of the company have full control and may alter them according to what they think fit. Only care has to be taken to see that regulations provided for in the articles do not exceed the powers of the company as laid down by its memorandum [Ashbury v. Watson, (1885) 30 Ch. D 376 (CA)]. Articles that go beyond the company's sphere of action are inoperative, and anything done under the authority of such article is void and incapable of ratification.

Section 7(1) provides that at the time of incorporation of a company the company shall file with the Registrar within whose jurisdiction the registered office of a company is proposed to be situated, the memorandum and articles of the company duly signed by all the subscribers to the memorandum in the prescribed manner.

Every type of company whether public or private and whether limited by shares or limited by guarantee having a share capital or not having a share capital or an unlimited liability company must register their articles of association.

### Entrenchment provisions of Articles

The articles may contain provisions for entrenchment to the effect that specified provisions of the articles may be altered only if conditions or procedures that are more restrictive than those applicable in the case of a special resolution, are met or complied with. [Section 5 (3)]

The provisions for entrenchment referred to in section 5(3) shall be made either (a) on formation of a company, or (b) by an amendment in the articles agreed to by all the members of the company in the case of a private company and by a special resolution in the case of a public company. [Section 5 (4)]

Where the articles contain provisions for entrenchment, whether made on formation or by amendment, the company shall give notice to the Registrar in Spice+ form at the time of the incorporation of the Company or E-form MGT-14 in case of existing Companies. The articles must be printed, divided into paragraphs, numbered consecutively, stamped adequately, signed by each subscriber to the memorandum and duly witnessed and filed along with the memorandum. The articles must not contain anything illegal or ultra vires the memorandum, nor should it be contrary to the provisions of the Companies Act 2013.

## Contents of Articles

The articles set out the rules and regulations framed by the company for its own working. The articles should contain generally the following matters:

- Exclusion wholly or in part of Table F, G, H, I or J.
- Adoption of preliminary contracts.
- Share Capital and variation of rights, if any.
- Terms governing issue and redemption of preference shares.
- Allotment of shares.
- Calls on shares.
- Lien on shares.
- Transfer and transmission of shares.
- Nomination.
- Forfeiture of shares.
- Alteration of capital.
- Buy back.
- General meetings, proceedings at general meetings, adjournment of meeting.
- Share certificates.
- Dematerialization.
- Conversion of shares into stock.
- Voting rights and proxies.
- Meetings and rules regarding committees of the Board.
- Directors, their appointment and delegations of powers.
- Nominee directors.
- Issue of Debentures and stocks.
- Audit committee.
- Managing director, Whole-time director, Manager, Secretary, Chief Executive Officer and Chief Financial Officer.

- Additional directors.
- Seal.
- Remuneration of directors.
- General meetings, proceedings at general meetings, adjournment of meeting.
- Board of Directors, Proceedings of the Board meetings.
- Borrowing powers
- Dividends and reserves.
- Accounts and audit.
- Winding up.
- Indemnity.
- Capitalization of profits, reserves.
- Secrecy.

Utmost caution must be exercised in the preparation of the articles of association of a company. At the same time, certain provisions of the Act are applicable to the company "notwithstanding anything to the contrary in the articles". Therefore, the articles must contain provisions in respect of all matters which are required to be contained therein so as not to hamper the working of the company later.

## Drafting of Articles of Association

Section 5 of the Act provides that the articles of association should be in any one of the Forms as specified in Tables F, G, H, I or J of Schedule I to the Companies Act, 2013.

**1)** the form in Table F is applicable to company limited by shares

**2)** the form in Table G shall be applicable to company limited by guarantee and having share capital

**3)** the form in Table H shall be applicable to company limited by guarantee and not having share capital

**4)** the form in Table I shall be applicable to unlimited company and having share capital

**5)** the form in Table I shall be applicable to unlimited company and not having share capital

## FORMATION AND REGISTRATION OF CORPORATE ENTITIES

As part of Government of India's Ease of Doing Business (EODB) initiatives, the Ministry of Corporate Affairs has notified & deployed a new Web Form 'SPICe+' (pronounced 'SPICe Plus') replacing the existing SPICe form. SPICe+ offer 11 services by 3 Central Government Ministries & Departments. (Ministry of Corporate Affairs, Ministry of Labour & Department of Revenue in the Ministry of Finance) and three State Govt.(Maharashtra, Karnataka and West Bengal ), thereby saving as many procedures, time and cost for Starting a Business in India and would be applicable for all new company incorporations w.e.f 23rd February, 2020.

**Features of SPICE+:**

SPICe+ is an integrated web form replacing the earlier version of the e-forms, the form is divided in to two parts viz.:

**Part A -** for Name reservation for new company and

**Part B -** offering a bouquet of services viz.

- Incorporation
- DIN allotment
- Mandatory issue of PAN
- Mandatory issue of TAN
- Mandatory issue of EPFO registration
- Mandatory issue of ESIC registration
- Mandatory issue of Profession Tax registration (Maharashtra, Karnataka and West Bengal)
- Mandatory Opening of Bank Account for the Company and
- Allotment of GSTIN (if so applied for)
- Allotment of Shops and Establishment Registration Number (only for Delhi location).

For the incorporation of company the user may either choose to submit Part-A for reserving a name first and thereafter submit Part B for incorporation & other services or file Part A and B together at one go for incorporating a new company and availing the bouquet of services as listed above. In case SPICe+ Part A is submitted individually for name reservation, Part B and all other linked forms shall be enabled only after the SRN of SPICE+ Part A is 'Approved' i.e. the name is reserved. Incorporation applications (Part B) after name reservation (In Part A) can be submitted as a seamless process in continuation of Part A of SPICe+. In form Spice+, stakeholders will not be required to even enter the SRN of the approved name as the approved name will be automatically displayed on the dashboard and a click on the same will take the user for continuation of the application through a hyperlink that will be available on the SRN/ application number in the new dashboard.

It may be noted that from 23rd February 2020 onwards, RUN service is applicable only for 'change of name' of existing company and the new web form facilitates on-screen filing and real time data validation for seamless incorporation of companies. The approved name and related incorporation details as submitted in Part A, would be automatically pre-filled in all linked forms also viz., AGILE-PRO, eMoA, eAoA, URC1, INC-9 (as applicable)

All Check form and Pre-scrutiny validations (except DSC validation) happen on webform itself. Once the SPICe+ is filled completely with all relevant details, the same would then have to be converted into pdf format, with just a click of the mouse button, for affixing DSCs. All digitally signed applications can then be uploaded along with the linked forms as per the existing process. Changes/modifications to SPICe+ (even after generating pdf and affixing DSCs), can also be done by editing the same web form application which has been saved, generating the updated pdf affixing DSCs and uploading the same.

Registration for EPFO and ESIC shall be mandatory for all new companies incorporated w.e.f. 23rd February 2020 and no EPFO & ESIC registration numbers shall be separately issued by the respective agencies. However, the Registration for Profession Tax shall also be mandatory for all new companies incorporated in the State of Maharashtra w.e.f. 23rd February, 2020.

All new companies incorporated through SPICe+ (w.e.f. 23rd February 2020) also be mandatorily required to apply for opening the company's Bank account through the AGILE-PRO linked web form.

Declaration by all Subscribers and first Directors in INC-9 is auto-generated in pdf format and would have to be submitted only in electronic form in all cases, except where:

- Total number of subscribers and/or directors is greater than 20 and/or
- Any such subscribers and/or directors has neither DIN nor PAN

## Step – I: Apply For Name Approval

**A. Login on MCA Website**

Applicant has to login into their account on MCA Website. (Pro-existing users can use earlier account or new users have to create a new account.)

After Login, user has to click on the icon SPICe+ in MCA Service. An online form shall be opened. Applicants have to fill the information online. (This form cannot be downloaded).

**B. Details required to be mentioned in online form:**

New fields introduced in Part A of SPICe+ are:

- Type of company
- Class of company
- Category of company
- Sub-Category of company
- Main division of industrial activity of the company
- Description of the main division

**C. Choose File:**

This option is available to upload the PDF documents. If applicant want to attach any file, it can be uploaded at this option.

**D. Submission of Form on MCA Website:**

After completion of above steps user shall submit the Form with MCA website.

**E. Validity of Reserved Name:**

Reserved name shall be valid for 20 days from the date of approval of name, whereas for change of name of existing company, the validity period of new name would be 60 days from the date of approval.

## Step – II: Preparation of Documents for Incorporation of Company

After approval of name or for Incorporation of Company, applicant has to prepare the below mentioned documents:

- INC-9 – Declaration by Subscriber(s) and director(s).
- DIR-2- Declaration from the proposed Directors along with Copy of Proof of Identity and residential address.
- Form MBP-1-Disclosure of interest in other entities.
- NOC from the owner of the property, where the registered office of the company will be located.
- Proof of Office address (Conveyance/ Lease deed/ Rent Agreement etc. along with rent receipts).
- Copy of the utility bills which should not be older than two months.
- In case of subscribers/ Director does not have a DIN, it is mandatory to attach: Proof of identity and residential address of the subscribers.
- All the Subscribers should have Digital Signature.
- Copy of PAN from the subscribers along with Proof of Identity and residential address.

## STEP – III: Fill the Information in Form

Once all the above mentioned documents/ information are available, applicant has to fill the information in theform "Spice+ Part -B.

**Features of SPICe+ (Inc-32) form:**

- Maximum details of subscribers are SEVEN (7). In case of more subscribers, physically signed MOA & AOA shall be attached to the Form.
- In case of a company having share capital, minimum authorized and subscribed share capital required for an OPC is Rupee one , for a private company having share capital is Rupees two and in case of a public company, Rupees seven. (as per Instruction Kit).
- Maximum details of directors are TWENTY (20).
- Maximum THREE (3) directors are allowed for filing application of allotment of DIN while incorporating a Company, other than a Producer Company.
- Person can apply for the name also in this form. (In SPICe+ Part A)
- By affixation of DSC of the subscriber on the INC-33 (MOA) date of signing will appear automatically in the form.
- Applying for PAN / TAN will be compulsory for all fresh incorporation applications filed in the new version of the SPICe form.
- Company can apply for Application for Goods and services tax Identification number, Employees State Insurance Corporation registration (ESIC), Employees Provident Fund Organization (EPFO) registration, and Professional tax Registration (in Maharashtra, Karnataka and West Bengal) and Opening of bank account through AGILE-PRO form.

- In case of companies incorporated, with effect from the 26th day of January, 2018, with a nominal capital of less than or equal to rupees fifteen lakhs or in respect of companies not having a share capital whose number of members as stated in the articles of association does not exceed twenty, fee on INC- 32 (SPICe+) shall not be applicable.

**SPICe+ (INC-32)-a Single Window Form for Incorporation of Company**

Earlier if a Person wants to incorporate a company, then it has to apply for the DIN for the proposed directors, seek approval for availability of name , separate form for first Director, Registered office address, PAN, TAN etc.

Now, this form is a single window for Incorporation of Company.

This form can be used for the following purposes:

- Application of DIN (upto 3 Directors)
- Application for Availability of Name– SPICe+ - Part A
- No need to file separate form for first Director (DIR-12)
- No need to file separate form for address of registered office (INC-22)
- No need to file separate form for PAN & TAN
- No need to file separately for GSTN.

**Points to Remember**

- In case of incorporation of a company having more than 7 subscribers, MOA & AOA shall be filed with SPICe+( INC 32) as Physical attachment in the respective format as specified in Table A to J in Schedule I without filing form INC 33 and INC 34 as Physical attachment of MOA & AOA in e-form INC 32.
- In case of incorporation of a company where any of the subscribers of the MOA/AOA is a foreign national, MOA & AOA shall be filed with INC 32 in the respective format as specified in Table A to J in Schedule I along with valid Business Visa (In case of Individual) and apostillised MOA and AOA (In case business Visa is not available ) and in such cases E-MOA (INC-33) and E-AOA (INC-34) are not required .Company has to pay the Stamp Duty in case of incorporation of Company with authorized Capital of Rs. 15 Lakh or below because Stamp Duty is a state matter. Companies Act has given exemptions for the ROC fees not for the stamp duty.
- Maximum 3 (Three) DIN can be applied through SPICE form. If applicant want to incorporate a Company with more than 3 Directors, applicant have to initially incorporate the Company with 3 Directors and have to appoint new directors later on after incorporation.
- Only one (1) Name can be applied for through SPICE+ form. After filing of e-form, if the name is not available, the applicant has to propose new name and have to alter the name on all the attachments of the Form.

**STEP – IV: Preparation of MOA & AOA (Electronic or Physical)**

- After proper filing of SPICE+ Pat B form, applicant has to download the e-form INC-33 (e-MOA) and INC34 (e-AOA) form the MCA site. After downloading of form as per requirement of Table A to J of Schedule I,fill in the form( it's a web form), convert to pdf and affix the DSC.
- After completely filling up of the form, affix DSC of all the subscribers, witness and professional on subscriber sheet of the MOA & AOA.

**STEP – V: Fill details of PAN & TAN**

It is mandatory to mention the details of PAN & TAN in the SPICe+ Form INC-32. Link to find out Area Code to file PAN & TAN are given in Help Kit of SPICE+ Form.

**STEP – VI: Fill details of GST, IEC in AGILE-PRO**

If Company wants to apply for GST ESIC, EPFO, Professional Tax registration (State of Maharashtra, Karnataka and West Bengal), Opening Bank Account and Shops Establishment Registration or Import Export Code (IEC), it has to select YES in the form and fill the information in the form.

**STEP – VII: Submission of INC-32, 33, 34, AGILE-PRO-S on MCA**

Once all the 4 forms are ready with the applicant, upload all four document as Linked form on MCA website and make the payment for the same. Where the Registrar on examining SPICe+ finds that it is necessary to call for further information or finds such application or document to be defective or incomplete in any respect, he shall give mark the application for resubmission. Only 2 (Two) resubmissions are allowed for SPICe+ froms. Each resubmission has to be replied within 15 (fifteen) days from the date of intimation given by the Registrar failing which the form will be liable for rejection.

**STEP – VIII: Certificate of Incorporation**

Incorporation certificate shall be generated with CIN, PAN & TAN in Form INC-11.

**Commencement of Business**

Under Section 10A, every company incorporated having a share capital shall not commence any business or exercise any borrowing powers unless

1) a declaration in form INC-20A is filed by a director within a period of one hundred and eighty day of the date of incorporation of the company in such form and verified by a Company Secretary or a Chartered Accountant or a Cost Accountant in practice with the Registrar that every subscriber to the memorandum has paid the value of the shares agreed to be taken by him on the date of making of such declaration; and
2) The company has filed with the Registrar a verification of its registered office in form INC-22 as provided in sub-section (2) of section 12.

**Precaution to be taken by Professionals**

1) Obtain engagement letter from subscriber: – As per certification in e-form DIR-12 & INC-22, a professional declares that he has been engaged for the purpose of certification. Therefore, the professional should take engagement letter from the promoters.

2) Verification of original records pertaining to registered office: – As per certification in e-form INC-22, a professional declares that he has verified all the particulars (including attachments) from original records.

3) **Ensure all attachments are clear enough to read:** – As per certification in e-form DIR-12 & INC-22, a professional declares that all attachments are completely and legibly attached.

4) **Ensure registered office of the company is functioning for the business purposes of the company:**

   As per certification in e-form INC-22, a professional declares that he has personally visited the registered office.

5) Take a declaration to the effect that all the original documents have been handed over after incorporation. Since as per section 7(4) copies all documents/information as originally filed should be preserved at the registered office of the company. Therefore, a professional should take a declaration while handing over the incorporation documents.

6) **MCA Circular 10/2014:** – According to this circular ROC/RD in case of omission of material fact or submission of false/incomplete/ misleading information, the Ministry can after giving opportunity of being heard, refer the matter to the e-governance division of MCA, which in turn may initiate proceedings under section 447 and/ or ask the respective professional institute to take requisite disciplinary action.

## PROCESS OF INCORPORATION OF A PUBLIC LIMITED COMPANY

Requirement of minimum number of directors and shareholders:

There is a minimum requirement of directors and shareholders, as mentioned below:

- Minimum Shareholders: 7 (Seven)
- Minimum Directors: 3 (Three)

**Statutory compliances**

A public or private company will have to comply with all the laws, rules and regulations as applicable, including but not limited to the Companies Act, 2013, Foreign Exchange Management Act, 1999, Shops and Establishment Act, Income Tax Act, etc., failing which , it may be subjected to penal action.

- There must be at least seven members to start a public company.
- There is no ceiling on the maximum number of members in a public company.
- A public company should have at least three directors.
- In a Public Limited Company, there must be at least five members, personally present at the General Meeting for constituting the requisite quorum.
- The shareholders of a public company can freely transfer their shares.
- A public company can invite the general public for subscribing to shares of the company.
- The shares of a public company can be listed on a recognized stock exchange and traded publicly.

## STEPS FOR INCORPORATION OF PUBLIC COMPANY

The Incorporation procedure for a public company is similar to the private company. However, it is to ensure that the proposed company is in compliance with the minimum requirement of the members and directors in a public company and the Articles and Memorandum of Association are drafted as per the requirement of the Act. The name shall be suffixed by the word "Limited". If there are any entrenchment clauses in the articles of the company, then such entrenchment shall be in compliance with the Act.

## PROCESS OF INCORPORATION OF A ONE PERSON COMPANY (OPC)

Section 2(62) of the Companies Act, 2013 define "One Person Company" as a company which has only one person as member. OPC is a type of Private Company as per Section 2(68) and Section 3(1) (c) of the Act.

**Rule 3** of the Companies (Incorporation) Rules 2014 say, only a natural person who is an Indian citizen and resident in India:-

- shall be eligible to incorporate a One Person Company;
- Shall be a nominee for the sole member of a One Person Company.

"Resident in India" means a person who has stayed in India for a period of not less than one hundred and twenty days during the immediately preceding financial year.

- A natural person shall not be member of more than one One Person Company at any point of time and the said person shall not be a nominee of more than one One Person Company.
- Where a natural person, being member in One Person Company in accordance with this rule becomes a member in another such Company by virtue of his being a nominee in that One Person Company, such person shall meet the eligibility criteria specified in sub rule (2) within a period of one hundred and eighty days.
- No minor shall become member or nominee of the One Person Company or can hold share with beneficial interest.
- Such Company cannot be incorporated or converted into a company under section 8 of the Act.
- Such Company cannot carry out Non-Banking Financial Investment activities including investment in securities of anybody corporates.

A natural person can be member of only one "One Person Company", at any point of time and the said person shall not be a nominee of more than a One Person Company. The subscriber to the memorandum of a One Person Company shall nominate a person, after obtaining prior written consent of such person, who shall, in the event of the subscriber's death or his incapacity to contract, become the member of that One Person Company.

The name of the person nominated shall be mentioned in the memorandum of One Person Company and such nomination shall also be mentioned in Form INC-32 (SPICe+), Single Application for incorporation of Company, along with consent of such nominee obtained in Form INC-3 and fee as provided in the Companies (Registration offices and fees) Rules, 2014 shall be filed with the Registrar at the time of incorporation of the company along with its memorandum and articles. SPICe+ Form (INC-32) is the prescribed form for incorporation of One Person Company.

## PROCESS OF INCORPORATION OF NIDHI

1. A Nidhi shall be a public company and shall have a minimum paid up equity share capital of ten lakh rupees.
2. Nidhi shall not issue preference shares, debentures or any other debt instruments.
3. If preference shares had been issued by a Nidhi before the commencement of the Companies Act, 2013, such preference shares shall be redeemed in accordance with the terms of issue of such shares.
4. No Nidhi shall have any object in its Memorandum of Association other than the object of cultivating the habit of thrift and savings amongst its members, receiving deposits from, and lending to, its members only, for their mutual benefit.
5. Every "Nidhi" shall have the last words 'Nidhi Limited' as part of its name.

Under Nidhi (Amendment) Rules, 2022 , the Central Government, on receipt of application (in Form NDH-4 along with fee thereon) of a public company for declaring it as Nidhi and on being satisfied that the company meets the requirements under these rules, shall notify the company as a Nidhi in the official Gazette. Thus, prior to this amendment, a public company could directly get incorporated as a Nidhi by the Registrar. After this amendment, in addition to following the procedure for incorporating a public company, the Central Government on receipt of NHD-4 will have to satisfy itself and notify the company as a Nidhi in the Official Gazette.

### Requirements for Minimum Number of Members and Net Owned Funds

Nidhi (Amendment) Rules, 2022 deals with requirements for minimum number of members, net-owned fund etc.

It provides that:

Every Nidhi shall, within a period of 120 days from the date of its incorporation, ensure that it has filed –

a. E-form NDH-4;
b. Net Owned Funds of 20 lakh rupees or more;
c. minimum of 200 persons as members;
d. unencumbered term deposits of not less than ten per cent of the outstanding deposits as specified in rule 14; and
e. ratio of Net Owned Funds to deposits of not more than 1:20.

It may be noted that "Net Owned Funds" means the aggregate of paid up equity share capital and free reserves as reduced by accumulated losses and intangible assets appearing in the last audited balance sheet. Further, the amount representing the proceeds of issue of preference shares shall not be included for calculating Net Owned Funds.

If a Nidhi is not complying with clauses (a) or (d) of sub-rule (1) above mentioned, it shall within thirty days from the close of the first financial year, apply to the Regional Director in Form NDH-2 along with fee specified in Companies (Registration Offices and Fees) Rules, 2014 for extension of time and the Regional Director may consider the application and pass orders within thirty days of receipt of the application.

Provided that the Regional Director may extend the period upto one year from the date of receipt of application. Where the failure to comply with sub-rule (1) above mentioned extends beyond the second financial year, Nidhi shall not accept any further deposits from the commencement of the second financial year till it complies with the provisions contained in sub-rule (1), and gets itself declared under sub-section (1) of section 406 besides being liable for penal consequences as provided in the Act.

## Return of Statutory Compliances by Nidhi

Within ninety days from the close of the first financial year after its incorporation and where applicable, the second financial year, Nidhi shall file a return of statutory compliances in Form NDH-1 along with such fee as provided in Companies (Registration Offices and Fees) Rules, 2014 with the Registrar duly certified by a company secretary in practice or a chartered accountant in practice or a cost accountant in practice.

However, the above mentioned compliance is not applicable for companies incorporated on after the commencement of Nidhi (Amendment) Rules, 2022.

## General restrictions or prohibitions

In terms of Rule 6, Nidhi shall not –

a. carry on the business of chit fund, hire purchase finance, leasing finance, insurance or acquisition of securities issued by any Body corporate;
b. issue preference shares, debentures or any other debt instrument by any name or in any form whatsoever;
c. open any current account with its members;
d. acquire or purchase securities of any other company or control the composition of the Board of Directors of any other company in any manner whatsoever or enter into any arrangement for the change of its management;
e. carry on any business other than the business of borrowing or lending in its own name. Nidhis which have adhered to all the provisions of these rules may provide locker facilities on rent to its members subject to the rental income from such facilities not exceeding twenty per cent of the gross income of the Nidhi at any point of time during a financial year;
f. accept deposits from or lend to any person, other than its members;
g. pledge any of the assets lodged by its members as security;
h. take deposits from or lend money to any Body corporate;
i. enter into any partnership arrangement in its borrowing or lending activities;
j. issue or cause to be issued any advertisement in any form for soliciting deposit;

   It may be noted that private circulation of the details of fixed deposit Schemes among the members of the Nidhi carrying the words "for private circulation to members only" shall not be considered to be an advertisement for soliciting deposits.

k. pay any brokerage or incentive for mobilizing deposits from members or for deployment of funds or for granting loans;
l. raise loans from banks or financial institutions or any other source for the purpose of advancing loans to members of Nidhi.

## PROCESS OF INCORPORATION OF SECTION-8 COMPANY

The procedure for registration of a Section 8 company is slightly different than incorporation of a private or public company. It involves two steps, namely:

i. obtaining of licence under section 8(1) of the Companies Act, 2013; and
ii. obtaining certificate of incorporation.

Before formation of the company, the promoters must decide on the following:

a. the proposed name to be applied;
b. objects to be carried by the Company;
c. proposed registered office address;
d. authorized capital;
e. Number of promoters, number of directors, and number of shares to be subscribed by each promoter.

In deciding the proposed name, the following rules have to be borne in mind:

i. The name of the company should be in consonance with the principal objects of the company as set out in the memorandum of association. Every name need not be necessarily indicative of the objects of the company, but when there is some indication of objects in the name, then it shall be in conformity with the objects mentioned in the memorandum. [Rule 8(2)(b)(ii) of Companies (Incorporation) Rules, 2014].
ii. The proposed name should not fall in the ambit of undesirable names specified in Rule 8 of Companies (Incorporation) Rules, 2014.
iii. Name of Section 8 Company shall include the words Foundation, Forum, Association, Federation, Chambers, Confederation, Council, Electoral trust and the like words. [Rule 8(7) of the Companies (Incorporation) Rules, 2014].
iv. There is no requirement to add the word Limited or Private Limited to its name. [Proviso to Section 4(1)(a) and Section 8(1)]

After deciding on the name and the structure of the proposed company, the following steps will be taken:

1. It has to be ensured that all the proposed directors should have valid DIN. If not, steps are to be taken for applying for DIN and obtaining the same.
2. Digital Signature for any one of the Directors is required to digitally sign the E-Forms to be submitted with the Registrar of Companies.
3. Memorandum of Association and Articles of Association have to be drafted. MOA of the Section 8 Company must be in form INC-13 (Rule 19) and AOA must be in the form INC-31 are must be taken to ensure see that:
    a. Objects of Section 8 Company must be the promotion of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment or any such other object. [Section 8(1)(a)]
    b. the proposed company should intend to apply its profits, if any or other income in promoting its objects. [Section 8(1)(b)]
    c. It should intend to prohibit the payment of dividend to its members. [Section 8(1)(c)].

4. The following provisions have to be noted before incorporation:
   a. There must be at least 2 or 3 subscribers to the memorandum in case company is proposed to be incorporated as private company or public company respectively. [Section 3(1)(a) and Section 3 (1)(b)]
   b. Minimum number of Directors required is 2 Directors or 3 Directors, in case company is proposed to be incorporated as private company or public company respectively with a maximum limit of up to 15 Directors. A Company may appoint more than 15 directors after passing a special Resolution in a general Meeting. [Section 149(1)(a) (b)]
   c. Section 8 company shall have at least one director who has stayed in India for a total period of not less than one hundred and eighty-two days during the financial year. [(Section 149(3)]

## Application for Incorporation

The incorporation procedure can be carried out through eForm SPICe+ which is a single application for reservation of name, incorporation of a new company and/or application for allotment of DIN and/or application for PAN and TAN. This eForm is accompanied by supporting documents including details of Directors & subscribers, MOA and AoA etc. It is to be noted that e-MOA (INC-33) and e-AOA (INC-34) is not applicable to Section 8 companies and physical copies of MOA and AOA are to be attached with the form SPICe+.

Once the e-Form is processed and found complete, company would be registered and CIN would be allocated. Also, DINs would be issued to the proposed Directors who do not have a valid DIN. Maximum three Directors are allowed for using this integrated form for filing application of allotment of DIN while incorporating a company. Also, PAN and TAN would get issued to the Company.

Earlier there were 2 Steps in the process of Incorporation of a Section 8 Company. First an application had to be made to the Central Government for the licence and once the licence was granted the Company could apply to the Registrar for Incorporation process.

In order to encourage the concept of 'Ease of Doing Business', the Form SPICe+ was introduced where both licence and the Certificate of Incorporation can be obtained by applying through a single form.

Incorporation application is filed in Form e forms SPICe+ along with the following attachments:

1. Memorandum of Association;
2. Article of Association;
3. Declaration by professional in Form INC 14 (Rule 19 (3) (b) of Companies (Incorporation) Rules, 2014) that the Memorandum and Articles have been drawn up in conformity with the provisions of Section 8 and rules made thereunder and all other requirements of the act relating to incorporation of a Section 8 Company have been complied with ;
4. Declaration by each of the persons making the application in the Form no. INC-15;
5. Declaration by First Directors and Subscribers;
6. Address Proof of the subscribers;
7. Identity proof of subscribers;

8. An estimate of the future annual income and expenditure of the company for next three years, specifying sources of income and the objects of the expenditure;
9. The verification of the registered office shall be filed in Form No. INC. 22 (when address for correspondence is the address of registered office of the company) and the following documents shall be attached thereto:
   a. the registered document of the title of the premises of the registered office in the name of the company; or
   b. the notarized copy of lease or rent agreement in the name of the company along with a copy of rent paid receipt not older than one month;
   c. the authorization from the owner or authorized occupant of the premises along with proof of ownership or occupancy authorization, to use the premises by the company as its registered office; and
   d. the proof of evidence of any utility service like telephone, gas, electricity, etc. depicting the address of the premises in the name of the owner or document, as the case may be, which is not older than two months.

   (Note: This is not required if the correspondence address given in the SPICe+ Form is the registered office of the Company as per Rule 38(8) of Companies (Incorporation) Rules, 2014.
10. Appointment of directors of the company in Form DIR - 12 along with the following attachments:
    - Consent to act as Directors in Form DIR- 2.
    - Affidavit by the Directors for Not accepting Deposits (On Non- judicial stamp paper of Rs. 100/- and duly notarised).
    - Declaration by each Subscriber to Memorandum of Association (On Non- judicial stamp paper of Rs. 100/- and duly notarised) in Form INC-9.
    - AGILE-PRO-S is applicable for incorporation of Section 8 Companies.

## Certificate of Incorporation

If the Concerned Registrar of Companies is satisfied that all the requirements of the Companies Act, 2013 have been complied with, a Certificate of Incorporation is issued which carries a unique Company Identification Number (CIN) in form INC-11, along with the license issued by the Central Government.

# Chapter 3 : Formation of LLP

## INTRODUCTION

The concept of LLPs emerged as a hybrid form of business entity that combines

- the flexibility and benefits of a partnership with
- the limited liability protection typically associated with a corporation.

The need for dedicated legislation for LLPs arose due to the limitations and complexities associated with traditional partnerships. LLP has become an alternative business vehicle to carry out business as it combines the characteristics of a private company and a conventional partnership.

The difference between LLP & traditional partnership firms is under a traditional partnership firm, every partner is liable, jointly and severally, with all the other partners for all acts of the firm done while he is a partner.

Under the LLP structure, the liability of the partner is limited to his agreed contribution. Additionally, individual partners are not held responsible for the independent or unauthorized actions of their counterparts. This provision ensures that partners can be protected from collective liability resulting from the wrongful acts or misconduct of another partner.

### Suitability of LLP

The LLP is an alternative operating vehicle that offers the distinctive feature of limited liability for its members while maintaining an open and flexible internal structure based on mutual understanding and a duly executed agreement. This flexibility makes LLP a suitable vehicle for small and medium enterprises and investment venture capitalists, which allows them to provide services with minimum cost and risk, thereby enhancing competitiveness in the global market and making it an attractive choice for their business endeavors and that is why nowadays many start-ups choose LLP over private companies.

## SALIENT FEATURES OF "LLP" OR "LLP"

- The name of every LLP must bear the words "LLP" or "LLP".
- Any two or more persons associated with carrying on a lawful business with a view to profit may by subscribing their names to an incorporation document and filing the same with the Registrar, form LLP.
- **LLP is a suitable structure for medium-sized businesses and commercial activities** such as manufacturing, trading, export, consultancy, professional services, education, joint ventures, and similar endeavors, unless specifically prohibited by notification.
- The incorporation procedure of LLP is, to a certain extent, similar to a company. LLP's incorporation documents (parallel to the memorandum) and LLP agreement (parallel to Articles of Association) are required to be filed online.
- **Minimum two partners, no limit on a maximum number of partners.** A minimum of two partners should be designated as 'Designated Partners', out of which one should be a resident of India to fulfil day-to-day statutory obligations under LLP Act. However, other partners are not normally liable except in cases of fraud etc.

- **LLP is a body corporate** which must be registered with the Registrar having a distinct name, and such name shall not be the same as other LLP, company or partnership firm already registered.
- **It is a separate legal entity** and a simple form of a partnership firm which holds the property in its name; thus, any type of debt of the LLP shall be borne by itself, and partners are separated from such obligations.
- LLP itself decide the relationship between the partners through its agreement thus, give the liberty to the partners to set the terms and conditions for effective business; however, subject to the LLP Act and Rules made there under.
- LLP activities are controlled and managed by its partners; whose name is specified in the incorporated documents. Designated partners have the fiduciary responsibility to carry on the day-to-day activities of the LLP.
- The right and duties of the LLP and its partners are defined in the LLP agreement.
- There is no limit on the capital contribution quantum that is to be made available in the business, just like a company where there is no requirement of the paid-up capital unless the context is otherwise provided.
- In the absence of the LLP agreement or any provisions therein, then the majority number of partners decide the specific matter by having one vote one partner. Also, material matters like the change of name, change in object or change in the registered office of the LLP etc., cannot be made unless the consent of all the partners.
- As the LLP itself is liable for the debts incurred to it to the full extent of its assets, this means that partners will be liable only for the limited contribution they have made to those assets, and likewise, partners may also be liable for their wrongful or fraudulent activity. It means that the personal asset of the partner of the LLP will not be at risk for the wrongful acts of the LLP or other partners. Thus, the separate legal entity limits the liability of its partners.
- LLP is also required to notify the Registrar if there is any change in name, registered office, terms and conditions of the LLP agreement. Also, it is required to submit the financials and annual return to the Registrar.
- LLP must display its name, place, registration number, and registered office address on all the conspicuous places of the business.
- LLP is capable of creating a charge over its movable and immovable property, thus enabling financial institutes to obtain finance. Also, the partners can lend money to the LLP in their personal capacity.
- Also, foreign direct investment is allowed in LLP, subject to the terms and conditions.
- Under the provisions of the LLP Act, a partnership firm, private company, or unlisted public company can be converted into an LLP.
- LLP can also take actions like compromise, arrangements, reconstructions, mergers, and amalgamations.
- Similarly, there are strike-off, winding up, dissolution, inspection and investigation provisions.

# IMPORTANT DEFINITIONS

## Body Corporate

Body Corporate means a company as defined in section 2(20) of the Companies Act, 2013 and includes

i. a LLP registered under this Act;
ii. a LLP incorporated outside India; and
iii. a company incorporated outside India,

but does not include

i. a corporation sole;
ii. a co-operative society registered under any law for the time being in force; and
iii. any other body corporate (not being a company as defined in section 2 (20) of the Companies Act, 2013 or a LLP as defined in this Act), which the Central Government may, by notification in the Official Gazette, specify in this behalf. [Section 2(1)(d)]

## Financial Year

Financial year, in relation to a LLP, means the period from the 1st day of April of a year to the 31st day of March of the following year.

However, in the case of a LLP incorporated after the 30th day of September of a year, the financial year may end on the 31st day of March of the year next following that year. [Section 2(1) (l)]

## Foreign LLP

Foreign LLP means a LLP formed, incorporated or registered outside India which establishes a place of business within India. [Section 2(1)(m)]

## LLP

LLP means a partnership formed and registered under this Act. [Section 2(1) (n)]

## LLP Agreement

LLP agreement means any written agreement between the partners of the LLP or between the LLP and its partners which determines the mutual rights and duties of the partners and their rights and duties in relation to that LLP. [Section 2(1) (o)]

## Partner

Partner, in relation to a LLP, means any person who becomes a partner in the LLP in accordance with the LLP agreement. [Section 2(1) (q)]

## Small LLP

Small LLP means a LLP—

i. the contribution of which, does not exceed Rs. 25 lakhs or such higher amount, not exceeding Rs. 5 crores, as may be prescribed; and
ii. the turnover of which, as per the Statement of Accounts and Solvency for the immediately preceding financial year, does not exceed Rs. 40 lakhs or such higher amount, not exceeding Rs. 50 crores, as may be prescribed; or

iii. which meets such other requirements as may be prescribed, and fulfils such terms and conditions as may be prescribed. [Section 2(1)(ta)]

## NATURE OF LLP

### LLP to be Body Corporate

According to Section 3 of the LLP Act, 2008, a LLP is a body corporate formed and incorporated under this Act and is a legal entity separate from that of its partners.

A LLP shall have perpetual succession. Any change in the partners of a LLP shall not affect the existence, rights or liabilities of the LLP.

It may be noted that the provisions of the Indian Partnership Act, 1932 shall not apply to a LLP.

## PARTNERS

Partner, in relation to a LLP, means any person who becomes a partner in the LLP in accordance with the LLP agreement.

Section 5 of the Act provides that any individual or body corporate may be a partner in a LLP.

An individual shall not be capable of becoming a partner of a LLP, if:

a) he has been found to be of unsound mind by a Court of competent jurisdiction and the finding is in force;
b) he is an undischarged insolvent; or
c) he has applied to be adjudicated as an insolvent and his application is pending.

### Minimum Number of Partners

Section 6 states that every LLP shall have at least two partners.

If at any time the number of partners of a LLP is reduced below 2 and the LLP carries on business for more than 6 months while the number is so reduced, the person, who is the only partner of the LLP during the time that it so carries on business after those 6 months and has the knowledge of the fact that it is carrying on business with him alone, shall be liable personally for the obligations of the LLP incurred during that period.

It may be noted that business includes every trade, profession, service and occupation except any activity which the Central Government may, by notification, exclude. [Section 2(1)(e)]

### Designated Partners

Section 7(1) of the Act provides that every LLP shall have at least 2 designated partners who are individuals and at least one of them shall be a resident in India.

However, in case of a LLP in which all the partners are bodies corporate or in which one or more partners are individuals and bodies corporate, at least 2 individuals who are partners of such LLP or nominees of such body corporate shall act as designated partners.

It may be noted that the term resident in India means a person who has stayed in India for a period of not less than 120 days during the financial year.

If the incorporation document:

a) specifies who are to be designated partners, such persons shall be designated partners on incorporation;

or

b) states that each of the partners from time to time of LLP is to be designated partner, every partner shall be a designated partner;

Any partner may become a designated partner by and in accordance with the LLP agreement and a partner may cease to be a designated partner in accordance with LLP agreement.

An individual shall not become a designated partner in any LLP unless he has given his prior consent to act as such to the LLP in such form and manner as may be prescribed.

Every LLP shall file with the Registrar the particulars of every individual who has given his consent to act as designated partner in such form and manner as may be prescribed within thirty days of his appointment.

An individual eligible to be a designated partner shall satisfy such conditions and requirements as may be prescribed.

Every designated partner of a LLP shall obtain a Designated Partners Identification Number (DPIN) from the Central Government and the provisions of sections 153 to 159 (both inclusive) of the Companies Act, 2013 shall apply mutatis mutandis for the said purpose.

### Liabilities of Designated Partners

As per Section 8 of the Act, a designated partner shall be-

a) responsible for the doing of all acts, matters and things as are required to be done by the LLP in respect of compliance of the provisions of this Act including filing of any document, return, statement and the like report pursuant to the provisions of this Act and as may be specified in the LLP agreement; and
b) liable to all penalties imposed on the LLP for any contravention of those provisions.

### Changes in Designated Partners

Section 9 provides that a LLP may appoint a designated partner within 30 days of a vacancy arising for any reason and provisions of section 7(4) & (5) shall apply in respect of such new designated partner.

It may be noted that if no designated partner is appointed, or if at any time there is only one designated partner, each partner shall be deemed to be a designated partner.

## INCORPORATION OF LLP

### Incorporation Document

Section 11(1) of the Act states that for a LLP to be incorporated,

a) two or more persons associated for carrying on a lawful business with a view to profit shall subscribe their names to an incorporation document;
b) the incorporation document shall be filed with the Registrar of the State in which the registered office of the LLP is to be situated; and
c) there shall be filed along with the incorporation document, a statement in the prescribed form, made by either an advocate, or a Company Secretary or a Chartered Accountant or a Cost Accountant, who is engaged in the formation of the LLP and by anyone who subscribed his name to the incorporation document, that all the requirements of this

Act and the rules made thereunder have been complied with, in respect of incorporation and matters precedent and incidental thereto.

According to Section 11(2) of the Act, the incorporation document shall be filed in Form FiLLiP with the Registrar having jurisdiction over the State in which the registered office of the LLP is to be situated along with prescribed fee.

- If an individual required to be appointed as designated partner does not have a DPIN or DIN, application for allotment of DPIN shall be made in Form FiLLiP.
- An Application for allotment of DPIN shall not be made by more than 5 individuals in Form FiLLiP.
- An Application for reservation of name may be made through Form FiLLiP.
- Where an applicant had applied for reservation of name under rule 18 in Form RUN-LLP and which has been approved, he may fill the reserved name as the proposed name of LLP.

Further, the incorporation document shall:

a) state the name of the LLP;
b) state the proposed business of the LLP;
c) state the address of the registered office of the LLP;
d) state the name and address of each of the persons who are to be partners of the LLP on incorporation;
e) state the name and address of the persons who are to be designated partners of the LLP on incorporation;
f) contain such other information concerning the proposed LLP.

Where the Registrar, on examining Form FiLLiP, finds that it is necessary to call for further information or finds such application or document to be defective or incomplete in any respect, he shall give intimation to the applicant to remove the defects and re-submit the e-form within 15 days from the date of such intimation given by the Registrar.

After re-submission of the document, if the Registrar still finds that the document is defective or incomplete in any respect, he shall give one more opportunity of 15 days' time to remove such defects or deficiencies. It may be noted that the total period for re-submission of documents shall not exceed 30 days.

The Certificate of Incorporation of LLP shall be issued by the Registrar in Form 16 and shall mention PAN and Tax Deduction Account Number issued by the Income Tax Department.

## Incorporation by Registration

According to Section 12(1) of the Act, when the requirements imposed by section 11(1)(b) &(c) have been complied with, the Registrar shall retain the incorporation document and, unless the requirement imposed by section 11(1)(a) of that sub-section has not been complied with, he shall, within a period of 14 days:

a) register the incorporation document; and
b) give a certificate that the LLP is incorporated by the name specified therein.

The certificate issued shall be signed by the Registrar and authenticated by his official seal.

The certificate shall be conclusive evidence that the LLP is incorporated by the name specified therein.

### Registered Office of LLP and Change therein

Section 13 of the Act states that every LLP shall have a registered office to which all communications and notices may be addressed and where they shall be received.

A document may be served on a LLP or a partner or designated partner thereof by sending it by post under a certificate of posting or by registered post or by any other manner, as may be prescribed, at the registered office and any other address specifically declared by the LLP for the purpose in such form and manner as may be prescribed.

A LLP may change the place of its registered office and file the notice of such change with the Registrar in such form and manner and subject to such conditions as may be prescribed and any such change shall take effect only upon such filing.

### Effect of Registration

Section 14 of the Act provides that on registration, a LLP shall, by its name, be capable of:

a) suing and being sued;
b) acquiring, owning, holding and developing or disposing of property, whether movable or immovable, tangible or intangible;
c) having a common seal, if it decides to have one; and
d) doing and suffering such other acts and things as bodies corporate may lawfully do and suffer.

## PARTNERS AND THEIR RELATIONS

### Eligibility to be Partners

According to Section 22 of the Act, on the incorporation of a LLP, the persons who subscribed their names to the incorporation document shall be its partners and any other person may become a partner of the LLP by and in accordance with the LLP agreement.

### Relationship of Partners

Section 23 provides that save as otherwise provided by this Act, the mutual rights and duties of the partners of a LLP, and the mutual rights and duties of a LLP and its partners, shall be governed by the LLP agreement between the partners, or between the LLP and its partners.

It may be noted that LLP Agreement means any written agreement between the partners of the LLP or between the LLP and its partners which determines the mutual rights and duties of the partners and their rights and duties in relation to that LLP. {Section 2(1) (o)}

The LLP agreement and any changes, if any, made therein shall be filed with the Registrar in prescribed form, manner and accompanied by such prescribed fees.

An agreement in writing made before the incorporation of a LLP between the persons who subscribe their names to the incorporation document may impose obligations on the LLP, provided such agreement is ratified by all the partners after the incorporation of the LLP.

In the absence of agreement as to any matter, the mutual rights and duties of the partners and the mutual rights and duties of the LLP and the partners shall be determined by the provisions relating to that matter as are set out in the First Schedule.

It may be noted that the First Schedule provides provisions regarding matters relating to mutual rights and duties of partners and LLP and its partners applicable in the absence of any agreement on such matters. The matters are as under:

1. The mutual rights and duties of the partners and the mutual rights and duties of the LLP and its partners shall be determined, subject to the terms of any LLP agreement or in the absence of any such agreement on any matter, by the provisions in this First Schedule.
2. All the partners of a LLP are entitled to share equally in the capital, profits and losses of the LLP.
3. The LLP shall indemnify each partner in respect of payments made and personal liabilities incurred by him:
   a) in the ordinary and proper conduct of the business of the LLP; or
   b) in or about anything necessarily done for the preservation of the business or property of the LLP.
4. Every partner shall indemnify the LLP for any loss caused to it by his fraud in the conduct of the business of the LLP.
5. Every partner may take part in the management of the LLP.
6. No partner shall be entitled to remuneration for acting in the business or management of the LLP.
7. No person may be introduced as a partner without the consent of all the existing partners.
8. Any matter or issue relating to the LLP shall be decided by a resolution passed by a majority in number of the partners, and for this purpose, each partner shall have one vote. However, no change may be made in the nature of business of the LLP without the consent of all the partners.
9. Every LLP shall ensure that decisions taken by it are recorded in the minutes within 30 days of taking such decisions and are kept and maintained at the registered office of the LLP.
10. Each partner shall render true accounts and full information of all things affecting the LLP to any partner or his legal representatives.
11. If a partner, without the consent of the LLP, carries on any business of the same nature as and competing with the LLP, he must account for and pay over to the LLP all profits made by him in that business.
12. Every partner shall account to the LLP for any benefit derived by him without the consent of the LLP from any transaction concerning the LLP, or from any use by him of the property, name or any business connection of the LLP.
13. No majority of the partners can expel any partner unless a power to do so has been conferred by express agreement between the partners.
14. All disputes between the partners arising out of the LLP agreement which cannot be resolved in terms of such agreement shall be referred for arbitration as per the provisions of the Arbitration and Conciliation Act, 1996.

## Cessation of Partnership Interest

As per Section 24 of the Act, a person may cease to be a partner of a LLP in accordance with an agreement with the other partners or, in the absence of agreement with the other partners as to cessation of being a partner, by giving a notice in writing of not less than 30 days to the other partners of his intention to resign as partner.

A person shall cease to be a partner of a LLP:

(a) on his death or dissolution of the LLP; or

(b) if he is declared to be of unsound mind by a competent Court; or

(c) if he has applied to be adjudged as an insolvent or declared as an insolvent.

Where a person has ceased to be a partner of a LLP (hereinafter referred to as former partner), the former partner is to be regarded (in relation to any person dealing with the LLP) as still being a partner of the LLP unless:

a) the person has notice that the former partner has ceased to be a partner of the LLP; or
b) notice that the former partner has ceased to be a partner of the LLP has been delivered to the Registrar.

The cessation of a partner from the LLP does not by itself discharge the partner from any obligation to the LLP or to the other partners or to any other person which he incurred while being a partner.

Where a partner of a LLP ceases to be a partner, unless otherwise provided in the LLP agreement, the former partner or a person entitled to his share in consequence of the death or insolvency of the former partner, shall be entitled to receive from the LLP:

a) an amount equal to the capital contribution of the former partner actually made to the LLP; and
b) his right to share in the accumulated profits of the LLP,

after the deduction of accumulated losses of the LLP, determined as at the date the former partner ceased to be a partner.

A former partner or a person entitled to his share in consequence of the death or insolvency of the former partner shall not have any right to interfere in the management of the LLP.

## Registration of Changes in Partners

Section 25 provides that every partner shall inform the LLP of any change in his name or address within a period of 15 days of such change.

A LLP shall:

a) where a person becomes or ceases to be a partner, file a notice with the Registrar within 30 days from the date he becomes or ceases to be a partner; and
b) where there is any change in the name or address of a partner, file a notice with the Registrar within 30 days of such change.

A notice filed with the Registrar:

a) shall be in such form and accompanied by such fees as may be prescribed;
b) shall be signed by the designated partner of the LLP and authenticated in a manner as may be prescribed; and

c) if it relates to an incoming partner, shall contain a statement by such partner that he consents to becoming a partner, signed by him and authenticated in the manner as may be prescribed.

Any person who ceases to be a partner of a LLP may himself file with the Registrar the notice of his cession.

If he has reasonable cause to believe that the LLP may not file the notice with the Registrar and in case of any such notice filed by a partner, the Registrar shall obtain a confirmation to this effect from the LLP unless the LLP has also filed such notice.

It may be noted that where no confirmation is given by the LLP within 15 days, the Registrar shall register the notice made by a person ceasing to be a partner under this section.

## EXTENT AND LIMITATION OF LIABILITY OF LLP AND PARTNERS

### Partner as Agent

Section 26 states that every partner of a LLP is, for the purpose of the business of the LLP, the agent of the LLP, but not of other partners.

### Extent of Liability of LLP

Section 27 of the Act provides that a LLP is not bound by anything done by a partner in dealing with a person if:

a) the partner in fact has no authority to act for the LLP in doing a particular act; and
b) the person knows that he has no authority or does not know or believe him to be a partner of the LLP.

The LLP is liable if a partner of a LLP is liable to any person as a result of a wrongful act or omission on his part in the course of the business of the LLP or with its authority.

An obligation of the LLP whether arising in contract or otherwise, shall be solely the obligation of the LLP.

The liabilities of the LLP shall be met out of the property of the LLP.

### Unlimited Liability in case of Fraud

According to Section 30(1) of the Act, in the event of an act carried out by a LLP, or any of its partners, with intent to defraud creditors of the LLP or any other person, or for any fraudulent purpose, the liability of the LLP and partners who acted with intent to defraud creditors or for any fraudulent purpose shall be unlimited for all or any of the debts or other liabilities of the LLP.

However, in case any such act is carried out by a partner, the LLP is liable to the same extent as the partner unless it is established by the LLP that such act was without the knowledge or the authority of the LLP.

Where any business is carried on with such intent or for such purpose as mentioned in Section 30(1), every person who was knowingly a party to the carrying on of the business in the manner aforesaid shall be punishable with imprisonment for a term which may extend to 5 years and with fine which shall not be less than Rs. 50,000 but which may extend to Rs. 5 lakh.

Where a LLP or any partner or designated partner or employee of such LLP has conducted the affairs of the LLP in a fraudulent manner, then without prejudice to any criminal proceedings which may arise under any law for the time being in force, the LLP and any such partner or

designated partner or employee shall be liable to pay compensation to any person who has suffered any loss or damage by reason of such conduct.

It may be noted that such LLP shall not be liable if any such partner or designated partner or employee has acted fraudulently without knowledge of the LLP.

### Whistle Blowing

Section 31(1) of the Act states that the Court or Tribunal may reduce or waive any penalty leviable against any partner or employee of a LLP, if it is satisfied that:

a) such partner or employee of a LLP has provided useful information during investigation of such LLP; or
b) when any information given by any partner or employee (whether or not during investigation) leads to LLP or any partner or employee of such LLP being convicted under this Act or any other Act.

Partner or employee of any LLP may not be discharged, demoted, suspended, threatened, harassed or in any other manner discriminated against the terms and conditions of his LLP or employment merely because of his providing information or causing information to be provided pursuant to Section 31(1).

## CONTRIBUTIONS

### Form of Contribution

Section 32 of the Act provides that a contribution of a partner may consist of tangible, movable or immovable or intangible property or other benefit to the LLP, including money, promissory notes, other agreements to contribute cash or property, and contracts for services performed or to be performed.

The monetary value of contribution of each partner shall be accounted for and disclosed in the accounts of the LLP in the manner as may be prescribed.

### Obligation to Contribute

Section 33 of the Act provides that the obligation of a partner to contribute money or other property or other benefit or to perform services for a LLP shall be as per the LLP agreement.

A creditor of a LLP, which extends credit or otherwise acts in reliance on an obligation described in that agreement, without notice of any compromise between partners, may enforce the original obligation against such partner.

## FINANCIAL DISCLOSURES

### Maintenance of Books of Account, other Records and Audit

According to Section 34(1) of the Act the LLP shall maintain such proper books of account as may be prescribed relating to its affairs for each year of its existence on cash basis or accrual basis and according to double entry system of accounting and shall maintain the same at its registered office for such period as may be prescribed.

Section 34 (2) states that every LLP shall, within a period of 6 months from the end of each financial year, prepare a Statement of Account and Solvency for the said financial year as at the last day of the said financial year in such form as may be prescribed, and such statement shall be signed by the designated partners of the LLP.

Rule 24(1) of the LLP Rules 2009 provides that every LLP shall keep books of accounts which are sufficient to show and explain the LLP's transactions and are such as to-

a) disclose with reasonable accuracy, at any time, the financial position of the LLP at that time; and
b) enable the designated partners to ensure that any Statement of Account and Solvency prepared under this rule complies with the requirements of the Act.

According to Rule 24(2) of the LLP Rules the books of account shall contain-

a) particulars of all sums of money received and expended by the LLP and the matters in respect of which the receipt and expenditure takes place;
b) a record of the assets and liabilities of the LLP;
c) statements of cost of goods purchased, inventories, work-in-progress, finished goods and cost of goods sold; and
d) any other particulars which the partners may decide.

Rule 24(3) states that the books of account which a LLP is required to keep shall be preserved for 8 years from the date on which they are made.

As per Rule 24(6) of the LLP Rules, Statement of Account and Solvency shall be signed on behalf of the LLP by its designated partners. Where the corporate insolvency resolution process has been initiated against the LLP under the Insolvency and Bankruptcy Code, 2016 or the LLP Act, 2008 has come under liquidation under the said Code, 2016 or the said Act, 2008, the said Statement of Account and Solvency may be signed on behalf of LLP by interim resolution professional or resolution professional, or liquidator or LLP administrator.

Rule 24 (7) of the LLP Rules states that the Statement of Account and Solvency of a LLP shall be signed by the designated partners of the LLP and each designated partner shall be taken to be a party to its approval unless he shows that he took all reasonable steps to prevent their being approved and signed.

Section 34(3) provides that every LLP shall file within the prescribed time, the Statement of Account and Solvency prepared pursuant to sub-section (2) with the Registrar every year in such form and manner and accompanied by such fees as may be prescribed.

For the purposes of sub-section (3) of section 34, every LLP shall file the Statement of Account and Solvency in Form 8 with the Registrar, within a period of 30 days from the end of 6 months of the financial year to which the Statement of Account and Solvency relates. {Rule 24(4)}

As per Section 34(4) of the Act, the accounts of LLPs shall be audited in accordance with such rules as may be prescribed.

Provided that the Central Government may, by notification in the Official Gazette, exempt any class or classes of LLPs from the requirements of this sub-section.

Any LLP which fails to comply with the provisions of sub-section (3), such LLP and its designated partners shall be liable to a penalty of Rs. 100 for each day during which such failure continues, subject to a maximum of Rs. 1 lakh for the LLP and Rs. 50,000 for every designated partner. {Section 34(5)}

Any LLP which fails to comply with the provisions of sub-section (1), sub-section (2) and sub-section (4), such LLP shall be punishable with fine which shall not be less than Rs. 25,000, but

may extend to Rs. 5 lakhs and every designated partner of such LLP shall be punishable with fine which shall not be less than Rs. 10,000, but may extend to Rs. 1 lakh. {Section 34 (6)}

The statement of Account and Solvency of a LLP shall be signed by the designated partners of the LLP and each designated partner shall be taken to be a party to its approval unless he shows that he took all reasonable steps to prevent their being approved and signed. [Rule 24(7)]

Rule 24(8) of the LLP Rules provides that the accounts of every LLP shall be audited in accordance with LLP Rules.

However, LLP whose turnover does not exceed, in any financial year, Rs. 40 lakhs, or whose contribution does not exceed Rs. 25 lakhs shall not be required to get its accounts audited.

Provided further that if partners of such LLP decide to get the accounts of such LLP audited, the accounts shall be audited in accordance with these rules.

Provided also that where the partners of such LLP do not decide for audit of the accounts of the LLP, such LLP shall include in the Statement of Account and Solvency a statement by the partners to the effect that the partners acknowledge their responsibilities for complying with the requirements of the Act and the Rules with respect to preparation of books of account and a certificate in the form specified in Form 8.

Rule 24(9) of the Rules states that a person shall not be qualified for appointment as an auditor of a LLP unless he is a Chartered Accountant in practice.

According to Rule 24(10) an auditor or auditors of a LLP shall be appointed for each financial year of the LLP for auditing its accounts.

Rule 24(11) of the LLP Rules provides that the designated partners may appoint an auditor or auditors-

a) at any time for the first financial year but before the end of the first financial year,
b) at least 30 days prior to the end of each financial year (other than the first financial year),
c) to fill a casual vacancy in the office of auditor, including in the case when the turnover or contribution of a LLP exceeds the limits specified under sub-rule (8), or
d) to fill up the vacancy caused by removal of an auditor.

As per Rule 24(12) the partners may appoint an auditor or auditors where the designated partners have power to appoint under sub-rule (11) and have failed to appoint.

According to Rule 24(13) an auditor or auditors of an LLP shall hold office in accordance with the terms of his or their appointment and shall continue to hold such office till the period-

a) the new auditors are appointed, or
b) they are re-appointed.

Rule 24(14) provides that where no auditor has been appointed under sub-rule (11), any auditor in office shall be deemed to be re-appointed, unless-

a) the LLP agreement requires actual re-appointment, or
b) the majority of partners have determined that he should not be re-appointed and have given a notice to this effect to the LLP.

Provisions of sub-rule (14) shall be applicable without prejudice to the provisions of the rules relating to removal and resignation of auditors. {Rule 24 (15)}

Rule 24(16) states that a notice specified under clause (b) of sub-rule 14-

a) may be in hard copy or electronic form, and
b) must be authenticated by the person or persons giving it.

Rule 24 (17) provides that the remuneration of an auditor appointed by the LLP may be fixed by the designated partners or by following the procedure as laid down in the LLP agreement.

Rule 24 (18) of the LLP Rules states that:

a) the partners of a LLP may remove an auditor from office at any time by following the procedure as laid down in the LLP agreement.
b) where the LLP agreement does not provide for removal of an auditor, consent of all the partners shall be required for removal of the auditor from his office.

Rule 24 (19) LLP Rules provides that:

a) an auditor of an LLP may resign his office by depositing a notice in writing to that effect at the LLP's registered office.
b) where an auditor is unwilling to be re-appointed, he shall give a notice in writing to that effect at the LLP's registered office, not less than 14 days before the end of the time allowed for appointing the new auditor.
c) the notice under clause (a) or (b) is not effective unless it is accompanied by the statement of the circumstances connected with his ceasing to hold office.
d) the auditor's term comes to an end as on the date on which the notice is deposited or on such later date as may be specified in the notice.

## ANNUAL RETURN

Section 35(1) of the LLP Act provides that every LLP shall file an annual return duly authenticated with the Registrar within 60 days of closure of its financial year in such form and manner and accompanied by such fee as may be prescribed.

Every LLP shall file an annual return with the Registrar in Form 11.

The annual return of an LLP having turnover upto Rs. 5 crores during the corresponding financial year or contribution upto Rs. 50 lakhs shall be accompanied with a certificate from a designated partner, other than the signatory to the annual return, to the effect that annual return contains true and correct information. In all other cases, the annual return shall be accompanied with a certificate from a Company Secretary in Practice to the effect that he has verified the particulars from the books and records of the LLP and found them to be true and correct.

It may be noted that where the corporate insolvency resolution process has been initiated against the LLP under the Insolvency and Bankruptcy Code, 2016 or the LLP Act, 2008 having turnover upto Rs. 5 crores during the corresponding financial year or contribution upto Rs. 50 lakhs rupees has come under liquidation under the said Code, 2016 or the said Act, 2008, the said annual return may be signed on behalf of LLP by interim resolution professional or resolution professional, or liquidator or LLP administrator and no certification by a designated partner shall be required.

As per Section 35 (2) of the Act, if any LLP fails to file its annual return under sub-section (1) before the expiry of the period specified therein, such LLP and its designated partners shall be liable to a penalty of Rs. 100 for each day during which such failure continues, subject to a maximum of Rs. 1 lakh for the LLP and Rs. 50,000 for designated partners.

## COMPOUNDING OF OFFENCES

According to Section 39(1) of the LLP Act, notwithstanding anything contained in the Code of Criminal Procedure, 1973, the Regional Director or any other officer not below the rank of Regional Director authorised by the Central Government may compound any offence under this Act which is punishable with fine only, by collecting from a person reasonably suspected of having committed the offence, a sum which may extend to the amount of the maximum fine provided for the offence but shall not be lower than the minimum amount provided for the offence.

Nothing contained in sub-section (1) shall apply to an offence committed by a LLP or its partner or its designated partner within a period of 3 years from the date on which similar offence committed by it or him was compounded under this section.

It is hereby clarified that any second or subsequent offence committed after the expiry of the period of 3 years from the date on which the offence was previously compounded, shall be deemed to be the first offence.

Every application for the compounding of an offence shall be made to the Registrar who shall forward the same, together with his comments thereon, to the Regional Director authorised by the Central Government, as the case may be.

Where any offence is compounded under this section, whether before or after the institution of any prosecution, intimation thereof shall be given to the Registrar within a period of 7 days from the date on which the offence is so compounded.

Where any offence is compounded before the institution of any prosecution, no prosecution shall be instituted in relation to such offence.

Where the compounding of any offence is made after the institution of any prosecution, such compounding shall be brought by the Registrar in writing, to the notice of the court in which prosecution is pending and on such notice of the compounding of the offence being given, the offender in relation to which the offence is so compounded shall be discharged.

The Regional Director while dealing with the proposal for compounding of an offence may, by an order, direct any partner, designated partner or other employee of the LLP to file or register, or on payment of fee or additional fee as required to be paid under this Act, such return, account or other document within such time as may be specified in the order.

Notwithstanding anything contained in this section, if any partner or designated partner or other employee of the LLP who fails to comply with any order made by the Regional Director the maximum amount of fine for the offence, which was under consideration of Regional Director or such authorised officer for compounding under this section shall be twice the amount provided in the corresponding section in which punishment for such offence is provided.

# LLP AGREEMENT

The LLP agreement is the most important document of an LLP. It is akin to the partnership deed of a partnership firm. The LLP agreement specifies the rights, duties, powers and other terms and conditions of the LLP. The partners have total freedom to decide about the various terms and conditions to be set out in the LLP agreement.

The LLP agreement is a written agreement divided into paragraphs drafted on a stamp paper of requisite value and is signed by all the partners. Two witnesses must sign on the last page. The LLP agreement must be registered with the Registrar and every subsequent alteration shall be made as per the provisions of the LLP Act, 2008 and registered with the Registrar.

## Objective of LLP Agreement

- LLP agreement defines the roles, responsibilities, rights, and powers of the partners to LLP and to each other. Hence, it creates the foundation for the smooth running of LLP.
- LLP agreement clarifies the managerial, operational as well administrative responsibilities and sets clear methodologies for decision making, adding a new partner and disassociation of existing partner.
- It defines the outlook and gives a clear idea as to decision making, adding a new partner, removal of existing partner, etc.
- Well drafted LLP agreement works like a backbone of the LLP.

## How to prepare LLP agreement

1. Draft the agreement and print it on the stamp paper of requisite value.
2. All partners should sign the agreement.
3. Two witness should sign the agreement on the last page.
4. Each partner should be provided with the copy of agreement.

## Essential Clauses of LLP agreement

Following are some of the essential clauses mentioned in the LLP Agreement:

1. **Interpretation / Definitions:** This clause is the essence of any LLP agreement. An LLP Agreement must provide for various definitions such as the definition of designated partners, the accounting period, business of LLP and the name with which the LLP will be known. The agreement must also provide the full address of the registered office of the LLP as well as the address of all the partners.
2. **Designated Partners:** LLP agreement shall clearly mention the name, age and address of each of the Designated Partners correctly.
3. **Name of the LLP and Changes to it:** This clause shall state that business of the LLP shall be carried on in the name and style of [Name of LLP]. Any change in the name of the LLP shall be notified to the Registrar by the Designated Partner(s) in accordance with the provisions of the LLP Act and the Rules.
4. **Registered office of the LLP:** LLP agreement shall state that partnership business shall be carried on at the under mentioned address, which shall also be its registered office The business shall also be carried from such other places as may be mutually decided by the partners from time to time.

5. **Business of the LLP:** The nature of business is stated clearly. The LLP may engage in any and all activities necessary, desirable or incidental to the accomplishment of the conduct of such business of the LLP including but not limited to such ancillary business. It may also include any other business conducted in such manner as may be decided by the majority of Partners from time.
6. **Capital Contribution:** Total contribution of the LLP and the contribution by each partner along with the percentage of contribution to be mentioned in this clause. If any partner is contributing in non-monetary form, that is, he / she is going to render services instead of monetary contribution, add the same. Manner of Additional capital contribution by partner during the course of agreement to be included as well. Manner in which contribution can be withdrawn by the partners shall also be stated in this clause.
7. **Profit Sharing Ratio:** An ideal LLP Agreement must also mention the ratio in which the profits and the losses of the business will be shared among the partners.
8. **Rights and Duties of Designated Partners:** The LLP Agreement must specify the rights and duties of the Designated Partners as may be mutually agreed by them. In the absence of such separate agreement between the partners about such rights and duties, etc., the provisions of Schedule I of the Limited Liability Act, 2008 will apply as given in Section 23(4) of the Act.
9. **Admission of Partner, Retirement Resignation and Expulsion of Partners:** LLP agreement must include the provisions regarding admission of new partners, retirement as well as the death of a partner, and guidelines for the expulsion of partners.
10. **Remuneration & Interest to be paid to Partners:** The LLP agreement shall contain a clause regarding the amount of remuneration to the Designated Partner(s), for rendering their services as such. The rate of interest to be paid to the partners on their capital contribution is also specified.
11. **Bank Account:** This clause shall set out the mode of operation of the bank account of the LLP.
12. **Books of Accounts and Accounting Year:** This clause shall contain matters relating to maintenance of books of accounts and other documents, method of accounting and the details relating to the Accounting year of the LLP.
13. **Meetings:** The LLP agreement shall clearly state the manner in which the decisions of LLP shall be taken in the meeting of the partners and shall also provide as to how the same shall be recorded in the minutes and the place of maintenance of such minutes book.
14. **Indemnity:** The LLP agreement should contain a provision regarding indemnities. The clause of indemnity states that the LLP must protect its partners from any kind of liability or claim incurred by them while carrying the business of the LLP. The partners should also agree to indemnify the LLP for the loss caused by it due to any breach committed by them.
15. **Dispute Resolution:** A well-drafted LLP must always contain a provision for resolving disputes between the members so that lengthy and expensive litigation is avoided. Generally, Arbitration [governed by the Arbitration and Conciliation act, 1996] is the preferred mode for resolving LLP disputes.

16. **Duration & Winding Up:** The partners must specify the term of validity of such LLP agreement -whether it is a perpetual agreement or is valid for a fixed period. The agreement must also provide for the situations when the partners have agreed to wind up the affairs of the LLP either voluntarily or by an order of Tribunal for the specific violations as mentioned in Section 64 of the Act.
17. **General Provisions:** The LLP agreement shall also include general provisions binding on legal heirs, successors, counterparts, serving of notices, waiver, Governing law etc.

## ANNUAL COMPLIANCES OF LLP

Following are certain annual compliances which needs to be complied by LLP form time to time basis:

| S. No. | Compliance | Form No. | When to file | Objective |
|---|---|---|---|---|
| 1. | Annual Return | 11 | Within 60 days of closure of its Financial year | Summary of management affairs of the LLP in the previous year. |
| 2. | Statement of Accounts & Solvency | 8 | Within 30 days from the end of the 6 months of the Financial year to which such Statement of accounts & Solvency relates to. | The statement that the LLP is in a position to discharge its debts. |
| 3. | Income Tax Return | IT return form | July 31$^{st}$ of the Assessment year** | Statutory requirement. |

# Chapter 4 : Startups and its Registration

## STARTUP INDIA POLICY

The "Startup India" initiative announced by the Hon'ble Prime Minister on 15th August, 2015 aims at fostering entrepreneurship and promoting innovation by creating an ecosystem that is conducive to growth of Startup.Startup India is a flagship initiative of the Government of India, intended to build a strong ecosystem for nurturing innovation and Startups in the country that will drive sustainable economic growth and generate large scale employment opportunities.

The efforts of the government are aimed at empowering Startups to grow through innovation and design. It is intended to provide the much needed impetus for the Startups to launch and scale greater heights. In order to meet the objectives of the initiative, the Hon'ble Prime Minister on 16th January 2016 launched the Startup India Action Plan.

Since, the launch of Startup India initiative, a total of 82,141 Startups has been recognized by DPIIT by 2022.

### Definition of Start-Up

**"Start Up as defined vide Notification No. G.S.R. 127 (E), dated 19th February 2019 by DPIIT as:**

An entity shall be considered as a Startup:

1. Upto a period of ten years from the date of incorporation/ registration, if it is incorporated as a private limited company (as defined in the Companies Act, 2013) or registered as a partnership firm (registered under section 59 of the Partnership Act, 1932) or a limited liability partnership (under the Limited Liability Partnership Act, 2008) in India.
2. Turnover of the entity for any of the financial years since incorporation/ registration has not exceeded Rs 100 crore.
3. Entity is working towards innovation, development or improvement of products or processes or services, or if it is a scalable business model with a high potential of employment generation or wealth creation.

Provided that an entity formed by splitting up or reconstruction of an existing business shall not be considered a 'Startup' The Startup India Action Plan consists of 19 action items spanning across areas such as "Simplification and handholding." "Funding support and incentives" and "Industry-academia partnership and incubation".

Since the launch of the programme, a number of forward looking strategic amendments to the existing policy ecology have been introduced, like:

- From digital/ technology sector to a wide array of sectors including agriculture, manufacturing, social sector, healthcare, education, etc.; and
- From existing tier 1 cities to tier 2 and tier 3 cities including semi-urban and rural areas.

The Startup India initiative was launched by the Government on 16th January 2016 to build a strong ecosystem for nurturing innovation, startups and encouraging investments in the startup ecosystem of the country. In order to meet these objectives, the Government unveiled an Action Plan for startups comprising of schemes and incentives envisaged to create a vibrant startup ecosystem in the country. The Action Plan comprises of 19 action items spanning across areas such as "Simplification and hand holding", "Funding support and incentives" and "Industry-academia partnership and incubation".

For attaining specific objectives, various programs are implemented by the Government under the Startup India initiative. As a result of sustained efforts, the Government has recognised 1,17,254 entities as startups as on 31st December 2023.

Realising the action items of the Startup India Action Plan, the Government is implementing flagship Schemes under Startup India initiative namely, Fund of Funds for Startups (FFS), Startup India Seed Fund Scheme (SISFS) and Credit Guarantee Scheme for Startups (CGSS) to support startups at various stages of their business cycle to enable startups to graduate to a level where they are able to raise investments or seek loans. The brief of each of the three flagship Schemes implemented under Startup India initiative are as under:

**Startup India Seed Fund Scheme (SISFS):** The Startup India Seed Fund Scheme has been approved for the period of 4 years starting from 2021-22 with a corpus of Rs. 945 crore. The Scheme aims to provide financial assistance to startups for proof of concept, prototype development, product trials, market entry and commercialization. The Scheme is implemented from 1stApril 2021. The Experts Advisory Committee (EAC), under SISFS, is responsible for the overall execution and monitoring of SISFS. The EAC evaluates and selects incubators for allocation of funds under the Scheme. As per provisions of the Scheme, the selected incubators shortlist startups based on parameters outlined in Scheme guidelines.

**Fund of Funds for Startups (FFS) Scheme:** The Fund of Funds for Startups Scheme was approved and established in June 2016 with a corpus of Rs 10,000 crore, with contribution spread over the 14th and 15th Finance Commission cycle based on progress of implementation, to provide much-needed boost to the Indian startup ecosystem and enable access to domestic capital. The Scheme is operationalized by Small Industries Development Bank of India (SIDBI). Under FFS, the Scheme does not directly invest in startups, instead provides capital to SEBI-registered Alternative Investment Funds (AIFs), known as daughter funds, who in turn invest money in growing Indian startups through equity and equity-linked instruments. SIDBI has been given the mandate of operating this Fund through selection of suitable daughter funds and overseeing the disbursal of committed capital. AIFs supported under FFS are required to invest at least 2 times of the amount committed under FFS in startups.

**Credit Guarantee Scheme for Startups (CGSS):** The Government has established the Credit Guarantee Scheme for Startups for providing credit guarantees to loans extended to DPIIT recognized startups by Scheduled Commercial Banks, Non-Banking Financial Companies (NBFCs) and Venture Debt Funds (VDFs) under SEBI registered Alternative Investment Funds. CGSS is aimed at providing credit guarantee up to a specified limit against loans extended by Member Institutions (MIs) to finance eligible borrowers viz. DPIIT recognised startups. CGSS is operationalized by the National Credit Guarantee Trustee Company Limited (NCGTC).

The details of various programs undertaken by the Government to promote startups across the country are as under:

1. **Startup India Action Plan:** An Action Plan for Startup India was unveiled on 16th January 2016. The Action Plan comprises of 19 action items spanning across areas such as "Simplification and handholding", "Funding support and incentives" and "Industry-academia partnership and incubation". The Action Plan laid the foundation of Government support, schemes and incentives envisaged to create a vibrant startup ecosystem in the country.
2. **Regulatory Reforms:** Over 50 regulatory reforms have been undertaken by the Government since 2016 to enhance ease of doing business, ease of raising capital and reduce compliance burden for the startup ecosystem.
3. **Ease of Procurement:** To enable ease of procurement, Central Ministries/ Departments are directed to relax conditions of prior turnover and prior experience in public procurement for all DPIIT recognised startups subject to meeting quality and technical specifications. Further, Government e-Marketplace (GeM) Startup Runway has been developed which is a dedicated corner for startups to sell products and services directly to the Government.
4. **Support for Intellectual Property Protection:** Startups are eligible for fast-tracked patent application examination and disposal. The Government launched Start-ups Intellectual Property Protection (SIPP) which facilitates the startups to file applications for patents, designs and trademarks through registered facilitators in appropriate IP offices by paying only the statutory fees. Facilitators under this Scheme are responsible for providing general advisory on diff¬erent IPRs, and information on protecting and promoting IPRs in other countries. The Government bears the entire fees of the facilitators for any number of patents, trademark or designs, and startups only bear the cost of the statutory fees payable. Startups are provided with an 80% rebate in filing of patents and 50% rebate in filling of trademark vis-a-vis other companies.
5. **Self-Certification under Labour and Environmental laws:** Startups are allowed to self-certify their compliance under 9 Labour and 3 Environment laws for a period of 3 to 5 years from the date of incorporation.
6. **Income Tax Exemption for 3 years:** Startups incorporated on or after 1st April 2016 can apply for income tax exemption. The recognized startups that are granted an Inter-Ministerial Board Certificate are exempted from income-tax for a period of 3 consecutive years out of 10 years since incorporation.
7. **International Market Access to Indian Startups:** One of the key objectives under the Startup India initiative is to help connect Indian startup ecosystem to global startup ecosystems through various engagement models. This has been done though international Government to Government partnerships, participation in international forums and hosting of global events. Startup India has launched bridges with over 17 countries that provides a soft-landing platform for startups from the partner nations and aid in promoting cross collaboration.

8. **Faster Exit for Startups:** The Government has notified Startups as 'fast track firms' enabling them to wind up operations within 90 days vis-a-vis 180 days for other companies.
9. **Startup India Hub:** The Government launched a Startup India Online Hub on 19th June 2017 which is one of its kind online platform for all stakeholders of the entrepreneurial ecosystem in India to discover, connect and engage with each other. The Online Hub hosts Startups, Investors, Funds, Mentors, Academic Institutions, Incubators, Accelerators, Corporates, Government Bodies and more.
10. **Exemption for the Purpose Of Clause (VII)(b) of Sub-section (2) of Section 56 of the Act (2019):** A DPIIT recognized startup is eligible for exemption from the provisions of section 56(2)(viib) of the Income Tax Act.
11. **Startup India Showcase:** Startup India Showcase is an online discovery platform for the most promising startups of the country chosen through various programs for startups exhibited in a form of virtual profiles. The startups showcased on the platform have distinctly emerged as the best in their fields. These innovations span across various cutting-edge sectors such as Fintech, EntrepriseTech, Social Impact, HealthTech, EdTech, among others. These startups are solving critical problems and have shown exceptional innovation in their respective sectors. Ecosystem stakeholders have nurtured and supported these startups, thereby validating their presence on this platform.
12. **National Startup Advisory Council:** The Government in January 2020 notified constitution of the National Startup Advisory Council to advise the Government on measures needed to build a strong ecosystem for nurturing innovation and startups in the country to drive sustainable economic growth and generate large scale employment opportunities. Besides the ex-officio members, the council has a number of non-official members, representing various stakeholders from the startup ecosystem.
13. **Startup India Seed Fund Scheme (SISFS):** Easy availability of capital is essential for entrepreneurs at the early stages of growth of an enterprise. The capital required at this stage often presents a make-or-break situation for startups with good business ideas. The Scheme aims to provide financial assistance to startups for proof of concept, prototype development, product trials, market entry and commercialization.
14. **National Startup Awards (NSA):** National Startup Awards is an initiative to recognize and reward outstanding startups and ecosystem enablers that are building innovative products or solutions and scalable enterprises, with high potential of employment generation or wealth creation, demonstrating measurable social impact. Handholding support is provided to all the finalists across various tracks viz. Investor Connect, Mentorship, Corporate Connect, Government Connect, International Market Access, Regulatory Support, Startup Champions on Doordarshan and Startup India Showcase, etc.
15. **States' Startup Ranking Framework (SRF):** States' Startup Ranking Framework is a unique initiative to harness strength of competitive federalism and create a flourishing startup ecosystem in the country. The major objectives of the ranking exercise are

facilitating states to identify, learn and replace good practices, highlighting the policy intervention by states for promoting startup ecosystem and fostering competitiveness among states.

16. **Startup Champions on Doordarshan:** Startup Champions program on Doordarshan is a one-hour weekly program covering stories of award winning/ nationally recognised startups. It is telecasted inboth Hindi and English across Doordarshan network channels.
17. **Startup India Innovation Week:** The Government organises Startup India Innovation week around the National Startup Day i.e., 16th January, with the primary goal was to bring together the country's key startups, entrepreneurs, investors, incubators, funding entities, banks, policymakers, and other national/ international stakeholders to celebrate entrepreneurship and promote innovation.
18. **The Startup India Investor Connect Portal** has been co-developed under the Startup India Initiative with SIDBI, serving as an intermediary platform that links startups and investors in order to help entrepreneurs from various industries, functions, stages, regions, and backgrounds in mobilizing capital. The portal has been built with the aim to enable in particular; early-stage startups located anywhere in the country to showcase themselves to leading investors/ venture capital funds.
19. **National Mentorship Portal (MAARG):** In order to facilitate accessibility to mentorship for startups in every part of the country, the Mentorship, Advisory, Assistance, Resilience, and Growth (MAARG) program has been developed and launched under the Startup India Initiative.
20. **ASCEND**: Under ASCEND (Accelerating Startup Caliber & Entrepreneurial Drive), sensitization workshops on startups and entrepreneurship were conducted for all eight North Eastern States with the objective to capacitate and augment knowledge on key aspects of entrepreneurship and continue efforts towards creating a robust startup ecosystem in these States.
21. **Startup20 Engagement Group:** As a result of India's belief in startup ecosystem, a Startup20 Engagement Group under India's G20 Presidency has been institutionalised which is working towards harmonisation and cross collaboration amongst the largest global economies. The engagement group acts as the voice of the global startup ecosystem bringing together varied stakeholders on a common platform. The group aims to support startups by enabling synergies between startups, corporates, investors, innovation agencies and other key ecosystem stakeholders internationally and to create global synergies.

## Issue of sweat equity shares by Startup Companies

With the Amendment, The Companies (Share Capital and Debentures) Amendment Rules, 2020, dated 5th June, 2020, a startup company as defined in notification number G.S.R. 127(E), dated the 19th February, 2019 issued by the Department for Promotion of Industry and Internal Trade, Ministry of Commerce and Industry, Government of India, may issue sweat equity shares not exceeding 50% of its paid -up share capital upto 10 (ten) years from the date of its incorporation or registration. (Earlier the time period was upto 5 (five) years from the date of incorporation or registration).

## Recognition as Startups

The process of recognition of an eligible entity as startup shall be as under:

A. A Startup shall make an online application over the mobile app or portal set up by the DPIIT.

B. The application shall be accompanied by –

   a. a copy of Certificate of Incorporation or Registration, as the case may be, and

   b. a write-up about the nature of business highlighting how it is working towards innovation, development or improvement of products or processes or services, or its scalability in terms of employment generation or wealth creation.

C. The DPIIT may, after calling for such documents or information and making such enquires, as it may deem fit –

   a. recognise the eligible entity as Startup; or

   b. reject the application by providing reasons.

## Certification of the Inter-Ministerial Board for availing the Tax Benefit under Section 80-IAC

A Startup being a private limited company or LLP, which fulfils the conditions specified in sub-clause (i) and sub-clause (ii) of the Explanation to section 80-IAC of the Income Tax Act, 1961 may, for obtaining a certificate for the purposes of section 80-IAC of the Act, make an application in Form-1 along with documents specified therein to the Board and the Board may, after calling for such documents or information and making such enquires, as it may deem fit, –

i. grant the certificate referred to in sub-clause (c) of clause(ii) of the Explanation to section 80- IAC of the Act; or
ii. reject the application by providing reasons.

The "Board" means the Inter-Ministerial Board of Certification comprising of the following members:

i. Joint Secretary, Department of Promotion of Industry and Internal Trade, Convener;
ii. Representative of Department of Biotechnology, Member;
iii. Representative of Department of Science & Technology, Member.

Post getting recognition a Startup may apply for Tax exemption under section 80 IAC of the Income Tax Act. Post getting clearance for Tax exemption, the Startup can avail tax holiday for 3 consecutive financial years out of its first 10 years since incorporation.

## Eligibility Criteria for applying to Income Tax exemption (80IAC)

The entity should be a recognized Startup

- Only Private limited or a Limited Liability Partnership is eligible for Tax exemption under Section 80IAC.
- The Startup should have been incorporated after 1st April, 2016.

**Amendment in section 80-IAC to provide for income tax exemption to eligible startups:**

Under Section 80-IAC, the Startup incorporated after April 1, 2016 but before the 1st day of April, 2022 is eligible for getting 100% tax rebate on profit for a period of 3 years. The startups recognized under the Startup India policy can now claim tax benefits in 3 out of the first 10 years under Section 80-IAC of the Income-tax Act, 1961. Also, the annual turnover must not exceed Rs. 100 crores in the previous year relevant to the assessment year for which deduction is claimed.

## Tax Exemption under Section 56 of the Income Tax Act (Angel Tax)

Post getting recognition a Startup may apply for Angel Tax Exemption. Eligibility Criteria for Tax Exemption under Section 56 of the Income Tax Act:

**Approval for the purposes of clause (viib) of sub-section (2) of section 56 of the Act:**

A Startup shall be eligible for notification under clause (ii) of the proviso to clause (viib) of sub-section (2) of section 56 of the Act and consequent exemption from the provisions of that clause, if it fulfils the following conditions:

i. it has been recognised by DPIIT.
ii. aggregate amount of paid-up share capital and share premium of the startup after issue or proposed issue of share, if any, does not exceed, Rs. 25 crores:

   Provided that in computing the aggregate amount of paid-up share capital, the amount of paid-up share capital and share premium of Rs. 25 crores in respect of shares issued to any of the following persons shall not be included –

   a) a non-resident; or
   b) a venture capital company or a venture capital fund;

iii. It has not invested in any of the following assets –
   a) building or land appurtenant thereto, being a residential house, other than that used by the Startup for the purposes of renting or held by it as stock-in-trade, in the ordinary course of business;
   b) land or building, or both, not being a residential house, other than that occupied by the Startup for its business or used by it for purposes of renting or held by it as stock-in trade, in the ordinary course of business;
   c) loans and advances, other than loans or advances extended in the ordinary course of business by the Startup where the lending of money is substantial part of its business;
   d) capital contribution made to any other entity;
   e) shares and securities;
   f) a motor vehicle, aircraft, yacht or any other mode of transport, the actual cost of which exceeds Rs. 10 lakhs, other than that held by the Startup for the purpose of plying, hiring, leasing or as stock-in-trade, in the ordinary course of business;
   g) jewellery other than that held by the Startup as stock-in-trade in the ordinary course of business;

   Explanation – For the purposes of this paragraph -

   i. "specified company" means a company whose shares are frequently traded within the meaning of Securities and Exchange Board of India (Substantial

Acquisition of Shares and Takeovers) Regulations, 2011 and whose net worth on the last date of financial year preceding the year in which shares are issued exceeds one hundred crore rupees or turnover for the financial year preceding the year in which shares are issued exceeds two hundred fifty crore rupees.

A startup fulfilling conditions mentioned in para 4 (i) and para 4 (ii) shall file duly signed declaration in Form 2 to DIPP that it fulfills the conditions mentioned in para 4. On receipt of such declaration, the DPIIT shall forward the same to the CBDT.

## Indian States with Startup policies

States have a vital role to play in promoting the Startup ecosystem. One of the core strengths of India lies in its diversity, leading to enormous opportunities for cross-learning from each other. Only four State Governments were actively supporting Startups before the launch of Startup India through a State Startup policy. The Startup movement across the country was fragmented and there was a need for consolidating standalone efforts. Emphasis was also required simultaneously to encourage more and more States to undertake new initiatives. The national priority initiative has led to a wide spread movement across the country and presently 31 States have their own Startup policies. Many other States and Union Territories (UTs) are in the process of drafting their policies and operating guidelines. The core functioning of an enabling ecosystem in a State is a function of the policy framework and effective implementation of the same. In the journey of developing a conducive Startup community, it is important that States and UTs exchange and adopt good practices undertaken by each other.

Another important role of State is to reduce the regulatory burden on budding Startup founders by simplifying labour, taxation, land, and other laws and regulations under the State purview. Many States are organizing hackathons, boot camps, pitching sessions to promote Startups. Several other States have already begun to actively setup world class incubators for Startups across various sectors. However, a significant effort is required to accelerate the pace of these initiatives to be at par with the pace of growth of Startups. Concerted initiatives by States will accelerate the growth of Startup ecosystems in their respective territories and transform the country into a flourishing Startup Nation.

## Evolution across the Years

The States' Startup Ranking Framework is an ever-evolving tool with collaboration at its core. With learnings from previous years and consultation with States and Union Territories, three new Reform Areas were introduced to the framework:

1. **Capacity Building of Enablers** – This Reform Area focuses on holistic development through sensitization programs and trainings conducted for key stakeholders of the State startup ecosystem.
2. **Mentorship Support** – This Reform Area focuses on creating a large and accessible mentorship network within the State and the guidance provided by the State-supported mentors to the startups.

3. **Fostering Innovation and Entrepreneurship** – This Reform Area captures grassroots innovation, disruptive policies for startups, and the entrepreneurial spirit of the students.

## EXEMPTIONS FOR STARTUPS

To promote growth and help Indian economy, many benefits are being given to entrepreneurs establishing start-ups.

1. **Simple process**

   Government of India has launched a mobile app and a website for easy registration for startups. Anyone interested in setting up a startup can fill up a simple form on the website and upload certain documents. The entire process is completely online.

2. **Reduction in cost**

   The government also provides lists of facilitators of patents and trademarks. They will provide high quality Intellectual Property Right Services including fast examination of patents at lower fees. The government will bear all facilitator fees and the startup will bear only the statutory fees. They will enjoy 80% reduction in cost of filing patents.

3. **Easy access to Funds**

   A 10,000 crore rupees fund is set-up by government to provide funds to the startups as venture capital. The government is also giving guarantee to the lenders to encourage banks and other financial institutions for providing venture capital.

4. **Tax holiday for 3 Years**

   Startups will be exempted from income tax for 3 years provided they get a certification from Inter Ministerial Board (IMB).

5. **Apply for tenders**

   Startups can apply for government tenders. They are exempted from the "prior experience/turnover" criteria applicable for normal companies answering to government tenders.

6. **R&D facilities**

   Seven new Research Parks will be set up to provide facilities to startups in the R&D sector.

7. **No time-consuming compliances**

   Various compliances have been simplified for startups to save time and money. Startups shall be allowed to self-certify compliance (through the Startup mobile app) with 9 labour and 3 environment laws.

8. **Tax saving for investors**

   People investing their capital gains in the venture funds setup by government will get exemption from capital gains. This will help startups to attract more investors.

9. **Choose your investor**

   The startups will have an option to choose between the VCs, giving them the liberty to choose their investors.

10. **Easy exit**

In case of exit, a startup can close its business within 90 days from the date of application of winding up

11. **Meet other entrepreneurs**

Government has proposed to hold 2 startup fests annually both nationally and internationally to enable the various stakeholders of a startup to meet. This will provide huge networking opportunities.

## Benefits / Exemptions to Start-ups under the Companies Act, 2013

| Section | Description |
|---|---|
| **CHAPTER I**<br>**PRILIMINARY** | |
| **Section 2(40)- Definition of financial statement** | The financial statement in relation to a private company (if such private company is a start-up) may not include the cash flow statement [Exemption notification dated 13th June, 2017]. |
| **CHAPTER IV**<br>**SHARE CAPITAL AND DEBENTURES** | |
| **Section 54- Issue of sweat equity shares** | A start- up company may issue sweat equity shares not exceeding 50% of its paid up capital upto ten years from the date of its incorporation or registration [Section 54 read the Rule 8(4) of The Companies (Share Capital and Debenture) Rules, 2014] |
| **Section 62 – Further issue of share capital** | For the purposes of section 62(1)(b), an "Employee" does not include-<br>i. an employee who is a promoter or a person belonging to the promoter group; or<br>ii. a director who either himself or through his relative or through anybody corporate, directly or indirectly, holds more than ten percent of the outstanding equity shares of the company.<br>The aforementioned conditions shall not apply to a start-up upto ten years from the date of its incorporation or registration [Section 62 read with Explanation to rule 12(1) of the Companies (Share Capital and Debentures) Rules, 2014] |

| | |
|---|---|
| **CHAPTER V**<br>**ACCEPTANCE OF DEPOSITS BY COMPANIES** | |
| **Section 73- Prohibition on acceptance of deposit from public** | "Deposit" does not include an amount of twenty five lakh rupees or more received by a start-up company, by way of a convertible note convertible into equity shares or repayable within a period not exceeding ten years from the date of issue) in a single tranche, from a person [Section 2(31) read with Rule2(c) (xvii) of the Companies (Acceptance of Deposits) Rules, 2014] |
| **Section 73- Prohibition on acceptance of deposit from public r/w Rule 3 of the Companies (Acceptance of Deposits) Rules, 2014** | The maximum limit in respect of deposits to be accepted from members shall not apply to a private company which is a start- up, for ten years from the date of its incorporation [Second proviso to Rule 3(3) of the Companies (Acceptance of Deposits) Rules, 2014] |
| **Section 73- Prohibition on acceptance of deposit from public** | Clauses (a) to, (e) of sub-section (2) of section 73 shall not apply to a private company which is a start-up, for five years from the date of its incorporation [Exemption notification dated 13th June, 2017] |
| **CHAPTER VII**<br>**MANAGEMENT AND ADMINISTRATION** | |
| **Section 92- Annual Return** | In relation to a private company, which is a start-up, the annual return shall be signed by the company secretary, or where there is no company secretary, by the director of the company [Exemption notification dated 13th June, 2017], |
| **CHAPTER XII**<br>**MEETINGS OF BOARD AND ITS POWERS** | |
| **Sections 173 – Meetings of Board** | A private company, which is a start-up, shall be deemed to have compiled with the provisions of section 173, if at least one meeting of the Board of Directors has been conducted in each half of a calendar year and the gap between the two meeting is not less than ninety days [Exemption notification dated 13th June, 2017] |

| CHAPTER XXVIII<br>SPECIAL COURTS | |
|---|---|
| **Section 446B- Lesser penalties for One Person Companies or Small Companies.** | If a start-up company fails to comply with any of the provisions of the Companies Act, 2013, where penalty is payable. Such company, its officer in default or any other person, as the case may be, shall be liable to a penalty which shall not be more than one half of the penalty specified in such provisions subject to a maximum of **Rs. 2 lakh** in case of a company and Rs. 1 lakh in a case of an officer who is in default or any other person, as the case may be. |

## LIFE CYCLE OF START-UP

The stages of a startup lifecycle are clearly demarcated owing not only to the promulgation at clarity but also to the exponential growth rate of the startup ecosystem. Each stage presents a new set off challenges and hurdles for entrepreneurs, elucidating the imperativeness of its understanding. Largely, the startup lifecycle is segregated into 4 stages:

- Ideation and Development
- Validation
- Early Traction
- Growth/Exit

### Stage 1: Ideation and Development

The first stage of the startup lifecycle is ideation. It is categorised by the importance of testing feasibility of the products/service offered. It is at this stage that garnering a variety of opinions to further assess a business model takes precedence. Testing the potential viability of an entrepreneurs' business can help answer larger questions about government aid, regulations and other aiding factors as the business inches to the next stage. Some overarching considerations of the ideation and development stage are:

- Target Market
- Business Models
- Team Skill Sets

### Stage 2: Validation

Once on entrepreneur has evaluated feasibility of the idea and has highlighted broad scale business strategies, it is important to validate the product or services offered. The process involves defining goals, developing a value proposition and validating the same through customer feedback. This stage of a startup exudes high relevance as it drives the understanding of potential outcomes. Moreover, it highlights the features as considered in the ideation stage by giving the entrepreneur viability proof through testing. Some overarching considerations of the validation stage are:

- Validating and Testing of Prototypes

- Modifications

## Stage 3: Early Traction

It is at the Early Traction stage that a set of target customers may test efficacy of the product/ service offered validation of a product can portray definitive results to the outside world, a stage that may present its own set of challenges and visibly express revenue and cash flow. It may be helpful to iterate that a market for this product is created and developed at this stage.

The customer retention rate confirms the early traction of the company and its product. Startup acquires more customers by actively seeking funds from crowd funding agencies, angel investors or networks, incubators and seed grants from Government.

## Pivoting

Pivoting in startup usually occur when a company shifts its business strategy to accommodate changes in its industry, customer preferences, or any other factor that impacts its bottom line. It is essentially the process of a startup translating direct or indirect feedback into a change in its business model. Most successful companies go through several pivots to find product-market fit. What makes the experiment work is usually not one major pivot, but a series of experiments across customers, problem, product, and technology and growth channels.

## STAGE 4: GROWTH/EXIT

In the fourth stage of the startup lifecycle, the company has attained true economic health, has sufficient size and product-market penetration to ensure economic success, and earns average or above-average profits. The company can stay at this stage indefinitely, provided environmental changes do not hinder its market niche or ineffective management reduce its competitive abilities. At this stage, the company may choose to scale up or expand its market through mergers and acquisitions or preparing for an Initial Public Offering (IPO). Depending upon the strategy followed, some of the companies are successfully able to sustain the growth stage, rapidly scaling up their business to achieve valuation of more than $1 billion and become unicorns. These businesses offer ideal business for other startup across sectors and encourage them to scale up.

## REGISTRATION STEPS

**A. Incorporation of Business Entity:** Before getting registered as Start-up one must need to incorporate his business either as a Private Limited Company or a Partnership firm or a Limited Liability Partnership. Incorporation of Private Limited Company or a Limited Liability Partnership (LLP) can be made by filing the incorporation application with the Registrar of Companies (ROC) for the state where the registered office of the new entity is proposed to be established. In order to get a partnership firm registered, the application has to be filed for registration with the Registrar of Firms of the area in which the firm is proposed to be registered.

What form should your Startup Venture have?

### I. Formation of a Company in India

The law of companies in India is governed by the Companies Act, 2013 which is a comprehensive legislation and provides for provisions relating to all phases of a company's life, i.e. incorporation, management, mergers, winding up, etc.

A Registrar of Companies ('ROC') is appointed under the Act for designated regions, who is the nodal authority for affairs related to companies in that particular region

### II. Types of Companies in India

Any person can choose to incorporate either a company with unlimited liability or one with liability limited either by shares or guarantee. An incorporated company may take one of the following three forms:

#### i. Private Company

With restrictions on transfer of shares, and limited number of members, a private limited company enjoys greater flexibility, less legal formalities, and the small shareholders body facilitates prompt decisions. A private company must have a minimum of two directors. A private company may be converted into a public company for raising capital from the public, if need arises, by completing certain legal formalities as specified in the Companies Act.

#### ii. Public Company

Public companies are subject to stricter legal formalities. However, the free transferability of the shares of a public company and unlimited membership provides a larger base for raising of capital. Shares of a listed public company can be traded on stock exchange, which may open it to the scrutiny and watch of Securities and Exchange Board of India. A public company must have a minimum of seven members and three directors. Certain classes of public limited companies must have at least one third of the total number of directors as independent directors out of which one director has to be a woman director.

#### iii. One Person Company

This concept has been brought by the new Companies Act and states that One Person Company is in the nature of a private company which has only one person as its member/director.

At the time of incorporation, the memorandum of association must name a nominee for the sole member of an OPC. The minimum number of directors for an OPC is also one. OPC provides the option of limited personal liability of proprietors (as opposed to unlimited liability in sole proprietorship).

Businesses which currently run under the proprietorship model could get converted into OPC's without any difficulty. The questions of consensus or majority opinions do not arise in case of OPCs, and is suitable for small entrepreneurs with low risk taking capacity.

## III. Charter documents of a Company –

### 1. Memorandum of Association

The MoA sets out the objects for which the company is proposed to be incorporated in the manner provided hereunder: –

a) The first and foremost clause in MoA shall be the name of the proposed company suffixed with the words limited or private limited, as the case may be;

b) The state where the registered office of the company shall be situated.

The third clause contains the main objects for which the company is going to be formed/ incorporated.

### 2. Articles of Association

The articles of a company contain regulations for the management of the company. This document is confined to the applicability of the provisions of the companies act, on private or public limited company, as the case may be.

## IV. Legal formalities for incorporation of a company:

### 1. Pre-incorporation formalities

The below mentioned compliances are required to be carried out with regard to setting up of company in India: -

a) Digital Signature Certificates ('DSC') for the proposed directors of the company by preparing and filing of Incorporation documents as required under the provisions of the Companies Act, 2013.

b) Any person (not having DIN) proposed to become a first director in a new company shall have to make an application for DIN (Maximum 3) through web form SPICe+. The applicant is required to attach the proof of Identity and address along with the application. DIN would be allocated to User only after approval of the form.

c) The next step is filing of online application through Simplified Proforma for Incorporating Company electronically (SPICe+ -INC-32), with eMoA (INC-33), eAOA (INC-34) and AGILEPRO-S. SPICe+ form is an integrated web-form and an advanced version of the previous SPICe form (i.e. e-form INC-32). SPICe+ web form offers 11 services by 3 Central Government Ministries & Departments. (Ministry of Corporate Affairs, Ministry of

Labour & Department of Revenue in the Ministry of Finance) and three State Governments (Maharashtra, Karnataka &West Bengal), thereby saving as many procedures, time and cost for Starting a Business in India.

d) The final step of the incorporation process and obtaining a certificate of incorporation of the company.

**2. Post incorporation formalities:**

Once the certificate of incorporation has been issued by ROC, the company becomes a separate legal entity in the eyes of laws in India, and requires certain basic registrations to initiate the business which includes filing of application for obtaining a permanent account number, tax deduction account number in the name of the company and any other business specific registrations from the relevant government authorities i.e. Import- Export Code Number in case of company carrying out the business of import and/or export.

Further, every company shall be required to carry out certain compliances, as required under the provisions of the Companies Act, for their day to day activities which includes holding of first board meeting immediately after incorporation, convening the annual general meeting every year, maintaining all the secretarial records at the registered office of the company, maintaining of statutory registers, minutes books etc. of company in compliance with the Companies Act, 2013.

**B. Register with Start-up India:** Once the entity is incorporated, the business can be registered as a startup. The registration process is completely online and simple for the users. One needs to visit the Startup India website and click on the 'Register' button. After that one needs to enter his/her name, email id, mobile number, password and after that click on "Register" button. OTP will be sent to the email and other details like, the type of user, name and stage of the startup, etc. should be mentioned. After entering these details, the Startup India profile will be created. Once, the profile is created on the website, startups can apply for various acceleration, incubator/mentorship programmes and other challenges on the Startup India website along with getting access to various resources like Learning and Development Program, Government Schemes, State Polices for Startups.

**C. Get recognition from DPIIT:** The next step after creating the profile on the Startup India Website is to avail the Recognition from the Department for Promotion of Industry and Internal Trade (DPIIT). The recognition helps the startups to avail various benefits like access to high-quality intellectual property services and resources, relaxation in public procurement norms, self-certification under labour and environment laws, easy winding of company, access to Fund of Funds, tax exemption for 3 consecutive years and tax exemption on investment above fair market value.

For getting Recognition from DPIIT, log on to the registered profile (account) credentials on the Startup India website and click on the 'DPIIT Recognition for Startups' button under the 'Schemes and Policies' tab. Click on the 'Get Recognized

button on the next page. A new page will open. Scroll down this page and click on the 'Click here for submitting your application for recognition as a Startup' button.

D. **Application for Recognition:** On the 'Startup Recognition Form', the details has to be filled such as the entity details, full address (office), authorized representative details, directors/partner details, information required, startup activities and self-certification. Click on the plus sign on the right-hand side of the form and enter each section of the form. After entering all the sections of the 'Startup Recognition Form', accept the terms and conditions and click on the 'Submit' button.

E. **Documentation required for Registration:** Following documents should be kept ready for getting the registration completed on the Startup India Portal:

- Incorporation/Registration Certificate of your startup
- PAN Number
- Proof of funding, if any
- Authorization letter of the authorized representative of the company, LLP or partnership firm
- Proof of concept like pitch deck/website link/video
- Patent and trademark details, if any
- List of awards or certificates of recognition, if any.

F. **Getting the Recognition Number:** Once the application is made a recognition number will be generated for the startup. The certificate of recognition will be issued after the examination of all the documents which is usually done within 2 days after submitting the details online.

## Important Points for a Start-up

### 1. Choose the right legal structure for your startup:

Choosing an appropriate legal structure is one of the most crucial decisions for any startup. The decision should be taken based on individual circumstances and a host of factors such as nature/sector of business operation, business trajectory, regulatory and tax considerations, costs of formation and ongoing administration, external capital requirement and type of funding sought, of legal liability protection required, number of stakeholders, balance required between ownership and management, proposed mechanism for profit sharing or distribution amongst stakeholders, et al. Preferred entity structures for startups in India are limited liability partnership and private limited company.

### 2. Registrations and business licenses:

Post incorporation of a business entity in India, some necessary registrations are required and mandated by law. Any user who intends to incorporate company through SPICe+ web form can now also apply for GSTIN / Establishment code as issued by EPFO / Employer Code as issued by ESIC through this web form (INC-35). User is required to file application (SPICe+) for incorporation of a company accompanying linked e-form AGILE PRO S -"Application for registration of Goods and Service Tax Identification Number

(GSTIN), Employee State Insurance Corporation (ESIC) registration, Employees' Provident Fund organisation (EPFO) Registration and profession Tax Registration, Opening of Bank Account and Shops and Establishment Registration" along with E-MOA (INC-33) and E-AOA (INC-34) to obtain GSTIN / Establishment Code / Employer Code etc.

This process will be applicable only for Companies incorporated by MCA through SPICe+ application.

Other categories of applicants (Tax Deductor, Tax Collector, Casual Taxable person, ISD, etc.) for GSTIN shall follow the existing process of registration through Common Portal for GST registration Similarly, other type of establishment such as Factory shall follow the existing process of registration through Common Portal for EPFO & ESIC registration).

Business licenses are permits issued by government authority that allow startups to start/continue to operate a particular business within its territorial jurisdiction lawfully. The nature of business activity determines most license requirements.

Other determining factors may include the number of employees, location of business and the form of business ownership. Some examples are Food safety license, Health/Trade license, Shops & Establishment License etc.

### 3. Intellectual Property Protection:

Intellectual Property Rights are a very important asset class for a startup. Developing and protecting intellectual property with proper registration can help startups gain competitive advantage. It is essential to obtain trademark registration for the business name/trade name under the Trademarks Act. Registration of a company or business in India does not by itself give protection against others who might commence using identical or similar marks.

A trademark search should be conducted before deciding on these business name/ trade names to prevent any issues in future including potential infringement. All Intellectual Property (including trademark, copyright, design, trade secrets, inventions, patents, etc.) should be registered in the name of the entity and not in the name of the promoters/founders of the startup.

### 4. Founder Equity – Split and Vesting:

Founder equity should be split amongst founders based on the nature of role played by each founder along with their time, effort and capital contribution to the startup. Splitting founder equity equally by default without a thorough discussion on expectations and contribution generally leads to tension and unhappiness amongst founding teams as the startup matures.

Founder shares should be always subject to vesting schedule – typically over a period of three to four years. When vesting is imposed on a founder equity, the unvested shares held by the founder become subject to a contractual right to repurchase/transfer often at a nominal value, if one of the founders is terminated or voluntarily leaves the startup. This is very important to ensure future viability of the business.

## 5. Founder agreements:

The founder's agreement is the most valuable tool to establish the relationship between the founders of a startup. The agreement should represent a clear understanding between the founders on all key issues related to the startup. Founder agreements should clearly mention the roles and responsibilities of the founders and have clauses detailing the decision making and operating structure of the startup, founder equity split with vesting (explained above), assignment of all intellectual property in favour of the startup, termination of a promoter and exit process etc.

## 6. Employment contracts:

Startups must ensure to enter into clear employment contracts detailing terms and conditions of employment with their employees. While employment contracts are certainly valuable to the employees as it details terms regarding description of job profile, compensation and other associated benefits, a number of clauses may be inserted to safeguard and protect the interest of the startup – such as stopping employees from setting up competing entities (non- compete clause), poaching other employees/clients/ customer (non-solicitation clause), preventing employees from claiming any intellectual property right on the work done/developed during the course of employment (assignment of intellectual property rights).

## 7. Employee Stock Option Pool (ESOP):

ESOP's are incentives given to employees/directors of a company to attract talent and retain employees by rewarding them. ESOPs create a sense of ownership amongst employees. It is important to note that ESOPs are not shares. They are structured in a way that they are option to buy shares at a discounted price and can be exercised only after a certain vesting period which is decided by the company granting the ESOPs.

## 8. Third Party Agreements:

Prior to entering into a third-party agreement and while negotiating the terms, it is advisable to execute a non- disclosure agreement. If creation/development of intellectual property is a component of such a third- party agreement, it must clearly state that all rights to the intellectual property rights shall vest and be owned by the startup and the third-party shall not stake any claim on the same and will do all acts to ensure the protection of the intellectual property. Clauses related to breach, termination and dispute resolution should be well negotiated and captured in all third-party agreements.

## 9. Investment structuring:

One of the most challenging and time consuming aspects of operating a startup is to raise capital for working capital requirement and growth. In India, Investors (HNIs/Angels/Funds) invest in early and growth stage companies in different structures and on varied terms. It is imperative for startups to seek proper legal advice while negotiating the deal terms for investment and the rights of the investors.

Typically, as a process an intention document detailing the structure of the transaction called the term sheet is executed followed by due diligence of the startup and execution of investment related definitive agreements.

### 10. Compliance management:

Compliance and its importance is often overlooked by many startups. There are multiple laws applicable to specific entity structures under which separate event based and annual compliance is mandated. It is extremely critical for the sustainable growth of any business that the startup is in compliance with legal, secretarial, accounting, taxation, employee related and other associated compliances. The consequences of non- compliance can be levy of punitive fines on the startup.

## FINANCING OPTIONS AVAILABLE FOR STARTUP COMPANIES

Finance is the life blood of any business. In case the venture is self-funded there can be no better option than that. However, a Startup is mostly the result of a novel idea that is the brainchild of its founder(s) and more often than not, funds are always a challenge.

Funding asserts its importance for operative processes, research, development and multiple other primary business features for evolving businesses. However, it is the foremost consideration when contemplating growth and development of startups. Funding can be derived sources, it can help sustain the existing projects and enable expansion.

Depending on the stage of a startup, major sources of financing entrepreneurs may include:

- Saving of Founders
- Family and Friends
- Angel investors
- Venture Capital
- Incubator
- Government Funding
- Crowd Funding
- Internal Financing
- Bank Loan
- Venture Debt/IPO

## SEED CAPITAL

Startup business needs the nurturing of finance to explore and grow. The funding done at the nascent stage is called seed funding and the capital is known as a seed capital.

Technically, seed capital is the initial capital used at the time of starting the business. This capital can come from the founders, families or friends. It is required for the market research, product development, and other initial stage operations.

Seed funding permits exploration of the business idea and converting it into a viable product or service that further attracts venture capitalists. A business founder must be clear on how to utilise seed capital in the most optimum manner to ensure smooth transition to the advanced stage of the business.

Seed funding is a risky investment option, as most funding agencies would like to adopt a wait and watch approach to see whether the idea has a business potential. From the founder's point of view, the option of obtaining seed funding has to be carefully utilised as obtaining seed funding may result in dilution of ownership of the founder.

The paperwork involved in seed funding is relatively less and straightforward, compared to advanced rounds of funding. Even the legal fees required are also quite less as compared to the seed equity. The interest rates too are usually lower and there are mostly no restrictions in the manner of business working as it is still in the nascent stage.

Financing is generally of two types i.e. (a) equity financing; or (b) debt-financing.

## A. Equity Financing

Startups are usually equity financed/funded by way of a venture capital/ private equity investors and/or angel investors.

### i. Venture Capitalist/Private Equity

Venture capital ("VC") / Private Equity ("PE") is often the first large investment a startup can expect to receive. Convertible instruments are usually the preferred option and most commonly used securities for VC/PE investment which includes compulsory convertible preference shares and compulsory convertible debentures. The investor and startup will normally enter into a non-binding offer based on the preliminary valuation of the startup usually followed with a financial, legal and technical due diligence on the startup as required by the investors. Due-diligence will help the investors to finalize the representation and warranties and also to identify conditions precedent to the completion of investments and conditions subsequent in the aforesaid transaction documents.

Upon completion of due-diligence to the satisfaction of investor, such investments involve execution of essentially following transaction documents between the investors and startups:

**Funding Procedure**

a. A Term Sheet / Letter of Intent /Memorandum of understanding is entered into, setting out the following:
   - basic commercial understanding between the VC and the startup; and
   - legal terms for the agreements to follow the due-diligence.

b. The contracting parties will enter into a Share Subscription Agreement/ Debenture Subscription Agreement. It usually captures the following:
   - the issuance of shares in the share capital or debentures at subscription amount determined based on the valuation of the startup;
   - condition precedents to completion of transaction or conditions subsequent to be completed within the agreed time frame after the completion date;
   - sets of representation and warranties and indemnification resulting from due-diligence exercise or otherwise, etc.

c. Thereafter, the contracting parties may enter into a Shareholders' Agreement providing for the following:
   - Nomination/representation rights on the board of investee;
   - Information and reporting right and disclosure obligation of investee to the investors;
   - Redemption rights on debenture or preference shares;
   - Pre-emption rights, Right of First Refusal or Right of First Offer, Tag Along Right, Drag Along Rights, Lock-in-period for the investor or promoter's holding, put and call options, affirmative vote rights on certain reserved matters, anti-dilution provisions;

- Exit options to investors after the lock-in-period; etc.

d. Issuance of Securities through Private Placement process;
e. Filing of necessary eForms with ROC for completing the process of issuance and allotment of securities;
f. Amendment of AOA as per Shareholders' Agreement;
g. Completion of Conditions Subsequent.

### ii. Angel Investors

Angel investors are usually individuals or a group of industry professionals who are willing to fund the venture in return for an equity stake. Under the SEBI (Alternative Investment Funds) Regulations, 2012 which was subsequently amended in 2021, SEBI has made the following restrictions applicable to angel funds investing in an Indian company:

1. Angel funds shall invest in startups which:
   a) are not promoted or sponsored by or related to an industrial group whose group turnover exceeds Rs.300 crore; and
   b) are not companies with family connection with any of the angel investors who are investing in the company.
2. Investment by an angel fund in any venture capital undertaking shall not be less than Rs.25 Lakhs and shall not exceed Rs.10 Crores.
3. Investment by an angel fund in the venture capital undertaking shall be locked-in for a period of one year.

### iii. Bridge Round

Bridge round is a sort of financing option that helps startups "bridge" the gap between larger funding rounds. Bridge rounds can be termed as interim financing rounds raised between larger funding rounds. Bridge rounds are often structured as convertible debt. When a startup needs additional capital between two rounds of funding, they might raise a "bridge round". Bridge rounds also provide an interim cash infusion to capitalize the rapid growth or prepare for an IPO of start-ups. Startups will first target existing investors during the bridge round and raise from new investors, if additional funding is needed.

Example: M/s ABC & Ltd., is already approved for a term loan of INR 5,00,00,000/- from bank, but the loan is broken into tranches, with the first tranche set to come in six months, the company may seek a bridge loan. It can apply for a six-month short-term loan that gives it just enough money to survive until the first tranche hits the company's bank account.

### iv. Series Funding

After Seed Funding Round or Angel Funding Round and Bridge Funding Round, Series Funding Round will start like Series A to Z. Series preferred stock is the first round of stock offered during the seed or early stage round by a portfolio company to the venture capital investor. Series preferred stock is often convertible into common stock in certain cases such as an Initial public offering (IPO) or the sale of the company.

Series rounds are traditionally a critical stage in the funding of new companies. A typical series A round is in the range of $2 million to $10 million, purchasing 10% to 30% of the company. The capital raised during a series round is usually intended to capitalize the company for 6 months to 2 years as it develops its products, performs initial marketing and branding, hires its initial employees, and otherwise undertakes early stage business operations.

## SOURCES OF FUNDS

Because there are no public exchanges listing their securities, private companies meet venture capital firms and other private equity investors in several ways, including warm referrals from the investors' trusted sources and other business contacts; investor conferences and demo days where companies pitch directly to investor groups. As equity crowd funding becomes more established, startups are increasingly raising part of their Series round online using platforms such as Onevest or Seed Invest in the USA and Seeds in the UK, VC- Circle, Private Circle, Lets Venture and Tracxn Labs, etc. in India. These blended rounds include a mix of angel investors, strategic investors and customers alongside the offline venture capital investors.

### Structure

Smaller investment amounts are usually not worth the legal and financial expense, the burden on a company of adjusting its capital structure to serve new investors, and the analysis and due diligence on the part of institutional investors. A company that needs money for operations but is not yet ready for venture capital will typically seek angel capital. Larger amounts are usually unwarranted given the cost of business in fields such as software, data services, telecommunications, and so on. However, there are routinely series A rounds in excess of $10 million in fields such as pharmaceuticals, semiconductors, and real estate development.

Things to Know When Raising a 'Series A Round':

If a startup is looking to raise a Series A, it might be a good idea to get familiar with what venture funds looks for to ascertain if your company is Series A ready.

Most startups, even those who gets angel funding or seed-stage funding or investments from accelerators/ incubators, are unable to get follow-on funding.

The first time that a startup raises capital is normally called a 'seed round'. Other names include angel round or HNI round. Some even call it a pre-Series A round, but this term usually refers to a small interim fundraising exercise between the seed round and Series A.

1. **Be Series A Ready**

   If you are looking to raise a Series A, it might be a good idea to get familiar with what venture funds looks for to ascertain if your company is Series A ready. Promising unit economics, revenue, proof of business model, systems ready to support efficient scaling, product/market fit, customer acquisition strategy and success, quality of team are some key factors that are taken generally taken into consideration and it is wise to evaluate where you company stands against these metrics to figure if you are ready for Series A.

2. **Start Early**

   Fundraising in the current environment is a time consuming process - be realistic about the timeframe. Make sure you start the process at least 7-8 months prior to when you want to raise a Series A financing. The deal process has two parts, pre-term sheet and post-term sheet. Underestimating the time required inevitably leads to desperation and will often need to alter your funding strategy to include diverting attention to raise a bridge round to sustain the business.

3. **Leverage Your Network**

   Seed funding is more plentiful and easier to raise as compared to Series A. Leveraging your network and building genuine relationships before you start your Series A fundraise will make it easier for you to get potential meetings with investors. Reach out to your extended network and request them to reach out to their connections. These second degree networks have powerful and favourable outcome. Spreading word about your business through your network or through PR/marketing initiatives is always helpful.

4. **Practice your "Pitch"**

   The key is to take as many meetings as possible. Speak to other founders who have successfully raised Series-A and take their inputs for your pitch. Meet the low priority investors on your list first - they will ask you relevant question and provide you valuable feedback which you should incorporate in your pitch before meeting the top priority investors on your list. Treat the pitch a product – iterate on it until it is great.

5. **Create a Fundraise Momentum**

   Approaching multiple venture funds at the same time is a good idea to get a competitive dynamic into the process. Try keeping your conversations with interested investors moving along at as close to the same pace as possible. This may not be easy but is if you manage to orchestrate well, you may be able to negotiate from a high bargaining power that generally leads to better valuation and deal terms. Nothing accelerates the process and you landing up a term sheet from one VC – you are likely to get few more.

6. **Know the "standard market practice"**

   Keep yourself up to date with the commonly offered deal terms for a Series A. It is highly possible that the first version of your term sheet you receive is not exactly "founder-friendly". The strongest line of defence and the most accepted rationale for negotiating such terms is that they are not standard market practice.

7. **Get the deal terms right**

   It is imperative that you ensure that the deal terms for your Series A are right and consistent with the trajectory of your business. The Series A terms will play as a foundation for all future rounds – many of those same terms that you have signed up for in your Series A are likely to carry through to future rounds i.e. Series B or Series C – hence important to get them the right the first time itself.

8. **Engage a Professional**

   If you're raising venture capital – you need a professional who specializes in structuring venture capital financing. A professional who has done multiple such deals understands the nuances involved in structuring such rounds both from the perspective of which deal terms are important, what the "standard market practice" is and when to stay firm and when to concede to the investor. This will aid you to close your investment documents faster and more efficiently.

9. **Paperwork in place**

   Shorten your transaction closing time by having all paper work in place for due diligence. Ensure that your company's legal documentation and compliance is up to date and have your team put together all records relating to employees, past financing, corporate structure and establishment, client contracts, intellectual property, cap table, etc. The paperwork should be organized and ready for review by the Investor appointed legal counsel/diligence team.

10. **Raise 10-15% more than budgeted for**

    Within reason, if you have access to capital and the deal terms including dilution are decent, raise 10-15% more than budgeted as the business initiatives/operations don't always materialise as planned. Raise enough to allow you a fair shot to meet your milestones for the next round of financing so that you can channel all your focus on building the business and scaling it in the right direction. Raising every round of funding post Series A becomes significantly difficult and therefore is time consuming process and highly distracting. Additionally, there is a transaction cost every time you close an additional round.

## B. Debt Financing

### i. Loan from Banks & NBFCs

Loans from banks and NBFCs help finance the purchase of inventory and equipment, besides securing operating capital and funds for expansion. More importantly, unlike a VC or angels, which have an equity stake, banks do not seek ownership in your venture. However, there are several drawbacks of such funding option. Not only do you pay interest on loan but it also has to be done on time irrespective of how your business is faring.

They require substantial collateral and a good track record, besides the fulfilment of other terms and conditions and a lot of documentation as follows:

- Application for loan sanction by borrowers;
- Issue of sanction letter by the Bank;
- Agreement of Loan;
- Security/collateral documentation, such as (i) Deed of Mortgage; (ii) Deed of Hypothecation; (iii) Deed of guarantee; (iv) Share pledge agreement; (v) Memorandum of Entry; etc.

### ii. External Commercial Borrowings

External Commercial Borrowings (ECB) in form of bank loans, buyers' credit, suppliers' credit, securitized instruments (e.g. non-convertible, optionally convertible or partially convertible preference shares, floating rate notes and fixed rate bonds) can also be availed from non-resident lenders to fund the business requirement of a company. ECB can be accessed under two routes, viz., (i) Automatic Route; and (ii) Approval Route depending upon the category of eligible borrower and recognized lender, amount of ECB availed, average maturity period and other applicable factors.

ECB raised has also certain end use restrictions such as that it cannot be used for (a) on lending or investment in capital market; (b) acquiring a company in India; (c) real estate sector etc. Under ECB also the borrower needs to create certain charge on immovable assets, movable assets, financial securities and issue of corporate and / or personal guarantees in favour of overseas lender / security trustee, to secure the ECB raised by the borrower, subject to compliance of certain conditions as prescribed under ECB guidelines framed by Reserve Bank of India. The documentation on similar lines as mentioned under bank loan section above will need to be executed.

### iii. CGTMSE Loans

Under the Credit Guarantee Trust for Micro and Small Enterprises scheme launched by Ministry of Micro, Small & Medium Enterprises (MSME), Government of India to encourage entrepreneurs, one can get loans of up to 1 crore without collateral or surety. Any new and existing micro and small enterprise can take the loan under the scheme from all scheduled commercial banks and specified Regional Rural Banks, NSIC, NEDFi, and SIDBI, which have signed an agreement with the Credit Guarantee Trust.

## C. Initial Public Offering (IPO) to raise the funds or increase the magnitude of the business operations

During the IPO, the Company raises funds by offering and issuing equity shares to the public. An IPO allows a company to tap a wide pool of stock market investors to provide it with large volumes of capital for future growth. The existing shareholding will get diluted as a proportion of the company's shares. However, existing capital investment will make the existing shareholdings more valuable in absolute terms.

Companies can also issue of American Depository Receipts ("ADRs") or Global Depository Receipts ("GDRs") to raise funds from international stock investors. The promoter has certain obligations such as (a) meeting minimum contribution requirements; and (b) is generally subject to a 3 year lock-in once the IPO is concluded.

Various parties such as investment bankers, underwriters and lawyers need to be engaged as part of the procedure of IPO.

## D. Unconventional modes of financing options which are now becoming popular in India

### i. Crowd Funding

This is recent phenomena being practiced for getting seed funding through small amounts collected from a large number of people (crowd), usually through the Internet. Now we have companies existing in India which are specializing in "Crowd Funding".

The entrepreneur can get money for his venture by showcasing his idea before a large group of people and trying to convince people of its utility and success.

The entrepreneur needs to put up on a portal his profile and presentation, which should include the business idea, its impact, and the rewards and returns for investors. It should be supported by suitable images and videos of the project.

SEBI in 2014, even rolled out a 'Consultation Paper on Crowd funding in India' proposing a framework in the form of Crowd funding to allow startups and SMEs to raise early stage capital in relatively small sums from a broad investor base. The Consultation Paper defined Crowd funding as solicitation of funds (small amount) from multiple investors through a web-based platform or social networking site for a specific project, business venture or social cause. However SEBI not issued any further regulations in this regard.

### ii. Incubators

These set-ups precede the seed funding stage and help the entrepreneur develop a business idea or make a prototype by providing resources and services in exchange for an equity stake ranging from 2-10%. Incubators offer office space, administrative support, legal compliances, management training, mentoring and access to industry experts as well as to funding through angel investors or VCs. These are usually government-supported institutes like the IIMs or IITs, technical institutes or private business incubators run by industry veterans or companies. The incubation period can be 2-3 years and admission is rigorous. Some of the top options in India include IIM-Bangalore NSRCEL, Microsoft Accelerator and IIT-Kanpur, SIIC and the Shri Ram College of Commerce (SRCC).

## ENTREPRENEURSHIP

Entrepreneurship is defined as the process of making money, earning profits and increasing the wealth while posing characteristics such as risk taking, management, leadership and innovation. The term Entrepreneurship is a complicated term and gives various meaning depending on the situation.

The concept of Entrepreneurship has wide range of meanings. On one extreme an entrepreneur is a person of very high aptitude who pioneers change, possessing characteristics found in only a very small fraction of the population. On the other extreme, anyone who wants to work for himself is considered to be an entrepreneur.

That is, entrepreneurship is equated to simply starting one's own business. Most economists believe it is more than that. To some economists, the entrepreneur is one who is willing to bear the risk of a new venture if there is a significant chance for profit. Others emphasize the entrepreneur plays a role of an innovator who markets his innovation. Still other economists say that entrepreneurs develop new goods or processes that the market demands and are not currently being supplied.

**Four Key Elements of Entrepreneurship:**

- Innovation
- Risk taking
- Vision
- Organising Skills

**Traits of an Entrepreneur:**

- He is a person who develops and owns his own enterprise.
- He is a moderate risk taker and works under uncertainty for achieving the goal.
- He is innovative.
- Reflects strong urge to be independent.
- Persistently tries to do something better.
- Prepared to withstand the hard life.
- Determined but patient.
- Exhibits sense of leadership.
- Also exhibits sense of competitiveness.
- Takes personals responsibility.
- Oriented towards the future.
- Tends to persist in the face to adversity.
- Convert a situation into opportunity.

**Characteristics of an Entrepreneur:**

(i) **Mental Ability:** entrepreneur must have creative thinking and must be able to analyse problems and situations. He should be able to anticipate changes.

(ii) **Business Secrecy:** he should guard his business secrets from his competitors.

(iii) **Clear Objectives:** he must have clear objectives as to the exact nature of business or the nature of goods to be produced.

(iv) **Human Relation:** he must maintain good relations with his customers, employees etc. to maintain good relationship he should have emotional stability, personal relations, tactfulness and consideration.

(v) **Communication Ability:** he should have good communication skills means both the sender and the receiver should understand each other's message.

**How Entrepreneurship is different from a Startup?**

The primary distinction between the startup and entrepreneurship is that an entrepreneur refers to all business ventures, new or old. It includes small businesses, partnerships, firms, sole-proprietorship and corporations which can be based on a new idea or on an existing idea. On the other hand, a startup is a newly emerged business venture started by individual founders to meet a market gap. Startups mostly mean new businesses that are solving market's problems with unique ideas.

# Chapter 5 : Micro, Small & Medium Enterprises

## INTRODUCTION

Micro, Small and Medium Enterprises (MSME) sector has emerged as a highly vibrant and dynamic sector of the Indian economy over the last five decades. MSMEs not only play crucial role in providing large employment opportunities at comparatively lower capital cost than large industries but also help in industrialization of rural & backward areas, thereby, reducing regional imbalances, assuring more equitable distribution of national income and wealth. MSMEs are complementary to large industries as ancillary units and this sector contributes enormously to the socio-economic development of the country.

The Government of India has enacted the Micro, Small and Medium Enterprises Development (MSMED) Act, 2006 in terms of which the definition of micro, small and medium enterprises is specified. The Act was notified to address policy issues affecting MSMEs as well as the coverage and investment ceiling of the sector. The Act seeks to facilitate the development of these enterprises as also enhance their competitiveness. It provides the first-ever legal framework for recognition of the concept of "enterprise" which comprises both manufacturing and service entities. It defines medium enterprises for the first time and seeks to integrate the three tiers of these enterprises, namely, micro, small and medium. The Act also provides for a statutory consultative mechanism at the national level with balanced representation of all sections of stakeholders, particularly the three classes of enterprises; and with a wide range of advisory functions. Establishment of specific funds for the promotion, development and enhancing competitiveness of these enterprises, notification of schemes/programmes for this purpose, progressive credit policies and practices, preference in Government procurements to products and services of the micro and small enterprises, more effective mechanisms for mitigating the problems of delayed payments to micro and small enterprises and assurance of a scheme for easing the closure of business by these enterprises are some of the other features of the Act.

## THE MICRO, SMALL AND MEDIUM ENTERPRISES DEVELOPMENT ACT, 2006

The Micro, Small and Medium Enterprises Development Act, 2006 came into force on 02nd October, 2006. The definitions are provided under section 2 of MSMED Act, 2006.

### Important Definitions

Some of the important definitions as provided in the Act is mentioned below:

### Advisory Committee:

Section 2 (a) states that Advisory Committee means the committee constituted by the Central Government under sub-section (2) of section 7.

### Appointed Day:

Section 2(b) of the Act defines the term appointed day as to mean the day following immediately after the expiry of the period of fifteen days from the day of acceptance or the day of deemed acceptance of any goods or any services by a buyer from a supplier.

## Board:

"Board" means the National Board for Micro, Small and Medium Enterprises established under section 3.

## Enterprise:

Section 2(e) of the Act defines the term Enterprise as an industrial undertaking or a business concern or any other establishment, by whatever name called, engaged in the manufacture or production of goods, in any manner, pertaining to any industry specified in the First Schedule to the Industries (Development and Regulation) Act, 1951 (IDRA) or engaged in providing or rendering of any service or services.

## Medium Enterprise:

The term Medium Enterprise has been defined under Section 2(g) of the Act as to mean an enterprise classified as such under sub-clause (iii) of clause (a) or sub-clause (iii) of clause (b) of Sub-section (1) of Section 7. Section 7 deals with the classification of enterprises.

## Micro Enterprise:

Micro Enterprise under Section 2(h) has been defined to mean an enterprise classified as such under subclause (i) of clause (a) or sub-clause (i) of clause (b) of Sub-section (1) of Section 7.

## Small Enterprise:

Small Enterprise under Section 2(m) of the Act means an enterprise classified as such under sub-clause (ii) of clause (a) or sub-clause (ii) of clause (b) of Sub-section (1) of Section 7.

## Supplier:

The term supplier defined under Section 2(n) of the Act means a micro or small enterprise, which has filed a memorandum with the authority referred to in Sub-section (1) of Section 8, and includes: -

i. the National Small Industries Corporation, being a company, registered under the Companies Act, 1956;
ii. the Small Industries Development Corporation of a State or a Union territory, by whatever name called, being a company registered under the Companies Act, 1956;
iii. any company, co-operative society, trust or a body, by whatever name called, registered or constituted under any law for the time being in force and engaged in selling goods produced by micro or small enterprises and rendering services which are provided by such enterprises.

## Establishment of National Board for Micro, Small and Medium Enterprises

The Central Government shall establish a board under section 3 of MSMED Act, 2006 known as National Board for Micro, Small and Medium Enterprises. Its head office shall be in New Delhi.

Constitution of Board: The board shall consists of following members:

a. the Minister in charge of the Ministry or Department of the Central Government having administrative control of the micro, small and medium enterprises who shall be the ex officio Chairperson of the Board;

b. the Minister of State or a Deputy Minister, if any, in the Ministry or Department of the Central Government having administrative control of the micro, small and medium enterprises who shall be ex officio Vice- Chairperson of the Board, and where there is no such Minister of State or Deputy Minister, such person as may be appointed by the Central Government to be the Vice-Chairperson of the Board;
c. 6 Ministers of the State Governments having administrative control of the departments of small scale industries or, as the case may be, micro, small and medium enterprises, to be appointed by the Central Government to represent such regions of the country as may be notified by the Central Government in this behalf, ex officio;
d. 3 Members of Parliament of whom 2 shall be elected by the House of the People and one by the Council of States;
e. the Administrator of a Union territory to be appointed by the Central Government, ex officio;
f. the Secretary to the Government of India in charge of the Ministry or Department of the Central Government having administrative control of the micro, small and medium enterprises, ex officio;
g. 4 Secretaries to the Government of India, to represent the Ministries of the Central Government dealing with commerce and industry, finance, food processing industries, labour and planning to be appointed by the Central Government, ex officio;
h. the Chairman of the Board of Directors of the National Bank, ex officio;
i. the Chairman and Managing Director of the Board of Directors of the Small Industries Bank, ex officio;
j. the Chairman, Indian Banks Association, ex officio;
k. 1 officer of the Reserve Bank, not below the rank of an Executive Director, to be appointed by the Central Government to represent the Reserve Bank;
l. 20 persons to represent the associations of micro, small and medium enterprises, including not less than 3 persons representing associations of women's enterprises and not less than 3 persons representing associations of micro enterprises, to be appointed by the Central Government;
m. 3 persons of eminence, one each from the fields of economics, industry and science and technology, not less than 1 of whom shall be a woman, to be appointed by the Central Government;
n. 2 representatives of Central Trade Union Organizations, to be appointed by the Central Government; and
o. 1 officer not below the rank of Joint Secretary to the Government of India in the Ministry or Department of the Central Government having administrative control of the micro, small and medium enterprises to be appointed by the Central Government, who shall be the Member-Secretary of the Board, ex officio.

The Board shall meet at least once in every three months in a year.

Functions of the Board: Section 5 of MSMED Act, 2006 states about the main functions of the board which are as follows:

1. To examine the factors affecting the promotion and development of micro, small and medium enterprises and review the policies and programmes of the Central Government in regard to facilitating the promotion and development and enhancing the competitiveness of such enterprises.
2. To make recommendations on matters relating to promotion and development of micro, small and medium enterprises or on any other matter referred to it by the Central Government which, in the opinion of that Government, is necessary or expedient for facilitating the promotion and development and enhancing the competitiveness of the micro, small and medium enterprises.
3. To advise the Central Government on the use of the Fund or Funds constituted under section 12 of MSMED Act, 2006.

## Classification of Enterprises

The Government vide notification no. S.O. 2119 dated 26.06.2020 has notified the composite criteria of classification of MSMEs based on investment in plant and machinery or equipment and turnover of the enterprises by simplifying the Udyam Registration process for MSMEs by making it fully online, digital, and paperless and based on self-declaration. No documents or proof are required to be uploaded for registering as a Micro, Small and Medium Enterprise. Aadhaar and PAN are required for registration. PAN, GSTIN linked details on investment and turnover of enterprises are taken automatically from relevant Government databases.

The turnover with respect to exports is not counted in the limits of the turnover for any category of MSMEs. The criteria become applicable to all States/UTs with effect from 01.07.2020. Promotion and development of enterprises is a State subject. The Central Government supplements the efforts of the State/UT Governments through various schemes, programmes and policy initiatives for promotion, development and enhancing the competitiveness of MSMEs in the country uniformly including tier 2 and tier 3 cities.

Central Government vide Notification S.O. 1702(E) dated 1st June 2020 notifies the criteria for classification of Micro, Small and Medium Enterprises. Under the new definition, there will be no more distinction between Manufacturing and Service MSMEs.

i. A Micro enterprise, where the investment in plant and machinery or equipment does not exceed one crore rupees and turnover does not exceed five crore rupees;
ii. A Small enterprise, where the investment in plant and machinery or equipment does not exceed ten crore rupees and turnover does not exceed fifty crore rupees; and
iii. A Medium enterprise, where the investment in plant and machinery or equipment does not exceed fifty crore rupees and turnover does not exceed two hundred and fifty crore rupee.

MSME includes all establishment engaged either in manufacturing or rendering services but it does not include those enterprise which are engaged only in trading activities.

## Memorandum of MSME

Any person who intends to establish a micro or small enterprise, may, at his discretion, or a medium enterprise engaged in providing or rendering of services may, at his discretion; or a medium enterprise engaged in the manufacture or production of goods pertaining to any industry specified in the First Schedule to the IDRA, is required to file the memorandum of micro, small or, as the case may be, of medium enterprise with such authority as may be specified by the State Government or the Central Government (Section 8).

## Measures for Promotion and Development

The Central Government may, from time to time, for the purposes of facilitating the promotion and development and enhancing the competitiveness of micro, small and medium enterprises, particularly of the micro and small enterprises, by way of development of skill in the employees, management and entrepreneurs, provisioning for technological upgradation, marketing assistance or infrastructure facilities and cluster development of such enterprises with a view to strengthening backward and forward linkages, specify, by notification, such programmes, guidelines or instructions, as it may deem fit. (Section 9)

## Registration Process

1. The form for registration shall be as provided in the Udyam Registration portal.
2. There will be no fee for filing Udyam Registration.
3. Aadhaar number shall be required for Udyam Registration.
4. The Aadhaar number shall be of the proprietor in the case of a proprietorship firm, of the managing partner in the case of a partnership firm and of a karta in the case of a Hindu Undivided Family (HUF).
5. In case of a Company or a Limited Liability Partnership or a Co-operative Society or a Society or a Trust, the organisation or its authorised signatory shall provide its GSTIN and PAN along with its Aadhaar number.
6. In case an enterprise is duly registered as an Udyam with PAN, any deficiency of information for previous years when it did not have PAN shall be filled up on self-declaration basis.
7. No enterprise shall file more than one Udyam Registration: Provided that any number of activities including manufacturing or service or both may be specified or added in one Udyam Registration.
8. Whoever intentionally misrepresents or attempts to suppress the self-declared facts and figures appearing in the Udyam Registration or updation process shall be liable to such penalty as specified under section 27 of the Act.

It may be Noted that:

- An enterprise for the purpose of this process will be known as Udyam and its Registration Process will be known as 'Udyam Registration'.
- A permanent registration number will be given after registration.
- After completion of the process of registration, a certificate will be issued online.
- This certificate will have a dynamic QR Code from which the web page on our Portal and details about the enterprise can be accessed.

- There will be no need for renewal of Registration. No enterprise shall file more than one Udyam Registration. However, any number of activities including manufacturing or service or both may be specified or added in one Registration.

## BENEFITS OF TAKING UDYAM REGISTRATION

- It will be a permanent registration and basic identification number for an enterprise.
- MSME Registration is paperless and based on self-declaration.
- There will be no need for renewal of Registration.
- Any number of activities including manufacturing or service or both may be specified or added in one Registration.
- The Udyam Registration may also help MSMEs in availing the benefits of Schemes of Ministry of MSMEs such as Credit Guarantee Scheme, Public Procurement Policy, additional edge in Government Tenders & Protection against delayed payments etc.
- Becomes eligible for priority sector lending from Banks.

## NSIC REGISTRATION

NSIC enlists Micro & Small Enterprises (MSEs) under Single Point Registration scheme (SPRS) for participation in Government Purchases. The units enlisted under Single Point Registration Scheme of NSIC are eligible to get the benefits under Public Procurement Policy for Micro & Small Enterprises (MSEs) Order 2012 as notified by the Government of India, Ministry of Micro Small & Medium Enterprises, New Delhi vide Gazette Notification dated 23.03.2012 and amendment vide order no. S.O. 5670(E) dated 9th November 2018.The enlistment under SPRS is completely online.

Both manufacturing and service provider enterprises having MSME or Udyog Aadhaar registration are eligible for obtaining NSIC registration. To obtain registration, enterprises having MSME or Udyog Aadhaar registration can apply online or by submitting an application at one of the NSIC offices. On submission of the application, the NSIC forwards the application to a zonal branch or sub-branch office nearest to the applicant for completing technical inspection of the unit and forwarding of recommendation for NSIC registration. On receiving the inspection report, NSIC grants registration to the MSME unit.

**Benefits extended to MSEs having valid registration:**

1. Issue of the Tender Sets free of cost.
2. Exemption from payment of Earnest Money Deposit (EMD).
3. In tender participating MSEs quoting price within price band of L1+15 per cent shall also be allowed to supply a portion upto 25% of requirement by bringing down their price to L1 Price, where L1 is non MSEs.
4. Consortia facility for Tender Marketing.

Every Central Ministries/Departments/PSUs shall set an annual goal of minimum 25 per cent of the total annual purchases of the products or services produced or rendered by MSEs. Out of annual requirement of 25% procurement from MSEs, 4% is earmarked for units owned by Schedule Caste /Schedule Tribes and 3% is earmarked for the units owned by Women entrepreneurs. SPRS registered units are integral part of the supply chain to Government

## MSME SCHEMES

MSMEs are amongst the strongest drivers of economic development, innovation and employment. Constant efforts are being made towards up-liftment of MSMEs under "Self Reliant India" through various schemes of MSMEs. Following are the major MSME schemes implemented by the Government of India:

### A. Prime Minister's Employment Generation Programme (PMEGP)

The scheme aims to provide financial assistance to set up self-employment ventures and generate sustainable employment opportunities in rural as well as urban areas. And to generate sustainable and continuous employment opportunities to rural and unemployed youth as well as prospective traditional artisans and thereby halt occupational migration. The scheme is applicable to all individuals above the age of 18 years.

The scheme is designed in such a way that the own contribution of the beneficiary is 10% of the project cost in case of general category and 5% of the project cost in case of special category (SC/ST/OBC/PH/Women/Ex Servicemen/ NER) Beneficiaries. If the application for loan is approved, then the banks sanction and release the balance amount of 90 to 95 percent of the total project cost suitably for setting up of the units by the beneficiaries.

### B. 2nd Loan For Up-Gradation Of The Existing PMEGP/Mudra Units

The scheme caters to the need of the entrepreneurs for bringing new technology/ automation so as to modernize the existing unit. With an objective to assist existing units for expansion and upgradation, the scheme provides financial assistance to successful/well performing units. The scheme is applicable to all the existing well performing PMEGP/MUDRA units.

### C. Credit Guarantee Scheme For Micro & Small Enterprises (CGTMSE)

The main objective of this scheme is to encourage the first generation entrepreneurs to venture into self-employment opportunities by facilitating credit guarantee support for collateral free / third-party guarantee free loans to the Micro and Small enterprises (MSEs), especially in the absence of collateral. The scheme is applicable to all the existing entrepreneurs and aspiring entrepreneurs.

### D. Micro & Small Enterprises Cluster Development Programme (MSE-CDP) Scheme

This scheme is formulated to support the sustainability and growth of MSEs by addressing common issues such as improvement of technology, skills & amp; quality, market access, etc and to create/upgrade infrastructural facilities in the new/ existing Industrial Areas/Clusters of MSEs. Its main objective is:

- To set up Common Facility Centers (for testing, training, raw material depot, effluent treatment, complementing production processes, etc).
- Promotion of green & sustainable manufacturing technology for the clusters.

The scheme is applicable to the existing entrepreneurs (in form of a SPV). The key benefits of the scheme is Creation of Common Facility Centers including Plug & Play Facilities and Support for Infrastructure Development Projects including Flatted Factory Complexes.

### E. Scheme of Fund For Regeneration Of Traditional Industries (SFURTI)

The main objective of SFURTI is to organize traditional industries and artisans into collectives by increasing production and value addition to make products competitive and to promote traditional sectors and increase income of artisans providing sustainable employment. The scheme is applicable to existing artisans from traditional industries, Cluster of Artisans in sectors such as Handicraft, Textile, Agro-Processing, Bamboo, Honey, Coir, Khadi etc. The scheme aims toward assistance and support to traditional industry artisans and to provide them sustainable employment through Hard Intervention in setting up physical infrastructure with CFCs, raw material banks, latest machineries. Soft Intervention in skill development, market promotion initiatives, etc. in clusters is also induced through this scheme. SFURTI provides financial assistance of up to 90% (95% in NER, J&K and Hill Areas) of Hard Intervention cost and entire cost of Soft Intervention.

### F. Entrepreneurship And Skill Development Programme (ESDP) Scheme

ESDP scheme aims at promoting new enterprises, capacity building of existing MSMEs and inculcating entrepreneurial culture in the country. It is applicable to all the aspiring and existing entrepreneurs. It facilitates entrepreneurship/ self-employment awareness and motivation to different sections of the society including SC/ ST/ Women, differently abled, Ex-servicemen and BPL persons as career options. Entrepreneurship & Skill Training in Agro Based Products, Hosiery, Food & Fruit Processing Industries, Carpet Weaving, Mechanical Engineering Workshop/ Machine Shop, Heat Treatment, Electroplating, Basic/Advance Welding/ Fabrication/ Sheet metal work, Basic/ Advance Carpentry, Glass & Ceramics etc. is the main target of the scheme. The scheme make provision for management capacity building Training to existing entrepreneurs and their supervisory staff in Industrial Management, Human Resource Management, Marketing Management, Export Management/Documentation & Procedures, Materials Management, Financial/Working Capital Management, Information Technology, Digital Marketing, Quality Management/QMS/ISO 9000/EMS, WTO, IPR, Supply Chain Management, Retail Management, Logistics Management etc. The scheme widens the base of entrepreneurship by development, achievement, motivation and entrepreneurial skill to the different sections of the society.

### G. Assistance To Training Institutions (ATI) Scheme

The scheme targets to create and strengthen infrastructure and assistance for entrepreneurship and skill development training programmes. Providing proper support for infrastructure and capacity building of training institutions of Ministry of MSME and existing State level EDIs. The scheme also aims in supporting the skill development programmes by training institutions of the Ministry of MSME.

### H. Coir Vikas Yojana - Umbrella Scheme (Skill Upgradation and Mahila Coir Yojana)

The main objective of this scheme is to impart training in processing of coir and value addition to potential workers, coir artisans/entrepreneurs through field training centers and training institution of Coir Board. The scheme aims to provide self-employment opportunities to rural artisans including women artisans in regions processing coconut husk. It is applicable to all the aspiring and existing entrepreneurs. The main benefits of the scheme are:

- Training to personnel in the cadres of supervisors/ instructors/artisans in coir industry.
- EDPs/Workshops/Seminars/Awareness programmes on development of coir industry.
- Conducting Exposure tours to the rural artisans for familiarizing with the newly incorporated technologies in the coir sector.

**I. Procurement & Marketing Support (PMS) Scheme**

The scheme aims to promote new market access initiatives like organizing / participation in National / International Trade Fairs / Exhibitions / MSME Expo, etc. held across the country and to create awareness and educate the MSMEs about the importance / methods/ process of packaging in marketing, latest packaging technology, import-export policy and procedure, GeM portal, MSME Conclave, latest developments in international / national trade and other subjects / topics relevant for market access developments.

**J. International Cooperation (IC) Scheme**

The scheme aims to Capacity build MSMEs for entering export market by facilitating their participation in international exhibitions/fairs/conferences/seminar/ buyer-seller meets abroad as well as providing them with actionable market-intelligence and reimbursement of various costs involved in export of goods and services.

The Scheme provides opportunities to MSMEs to continuously update themselves to meet the challenges emerging out of changes in technology, changes in demand, emergence of new markets, etc.

**K. National SC-ST Hub Scheme**

The main objective of this scheme is to provide professional support to Scheduled Caste and Scheduled Tribe Entrepreneurs to fulfill the obligations under the Central Government Public Procurement Policy for Micro and Small Enterprises Order 2012, adopt applicable business practices and leverage the Stand-Up India initiatives.

The scheme is applicable to aspiring and Existing SC/ST Entrepreneurs.

**L. A Scheme for Promotion of Innovation, Rural Industries and Entrepreneurship (ASPIRE)**

The main objective of this scheme is to set up a network of Livelihood Business Incubation centers predominantly in the rural and underserved areas, to promote innovation and accelerate entrepreneurship by empowering the beneficiaries in creation of formal micro-enterprises and imparting skill development programs for creating wage/self-employment opportunities in the agro rural sector. The scheme is applicable to any agency/ institution of Government of India/ State government or existing training centers under Ministries/Departments of Government of India/State Government, Industry Associations, Academic Institutions and any not-for-profit private institutions with experience in successfully executing incubation and/or skill development programs may be eligible to set up an LBI.

### M. Credit Guarantee Scheme for Subordinate Debt (CGSSD) for Stressed MSMES

The main objective of this scheme is to provide Subordinate debt. Subordinate debt will provide a substantial help in sustaining and reviving the MSMEs which have either become NPA or are on the brink of becoming NPA. Promoter(s) may infuse this amount in MSME unit as equity and thereby enhance the liquidity and maintain debtequity ratio. In a situation, where an outright loan is difficult, sub-debt with guarantee will provide the requisite financing to the MSME Units. This Scheme seeks to extend support to the promoter(s) of the operational MSMEs which are stressed and have become NPA as on 30th April, 2020.

### N. Self-reliant India (SRI) Fund

This scheme is yet to be launched. India has embarked upon the path of self-reliant economic growth for achieving its aspiration of becoming an economic superpower. Towards this end, one of the initiatives taken by the Government of India is the launch of the Self Reliant India (SRI) Fund. The Fund structure is designed in a manner that it will leverage the strength of the private sector in providing growth capital to viable MSMEs having a definite growth plan.

SRI Fund will contribute towards achieving India's $5 trillion GDP target by creating a vibrant MSME ecosystem, and making an Aatmanirbhar Bharat.

### O. MSME Sambandh

MSME Sambandh Portal is launched as the Public Procurement Portal, whose main objective is to monitor the implementation of the Public Procurement from MSEs by Central Public Sector Enterprises. The Public Procurement Policy for Micro and Small Enterprises (MSME) order 2012 has mandated every Central Ministry/ Department/PSU shall set an annual goal for procurement from the MSE sector at the beginning of the year, with the objective of achieving an overall procurement goal of minimum 25 per cent of the total annual purchases from the products or services produced or rendered by MSEs. Out of 25% target of annual procurement 4% is exclusively reserved for MSEs owned by SC/ST and 3% for MSEs owned by Women entrepreneurs.

## REFERENCE TO MICRO AND SMALL ENTERPRISES FACILITATION COUNCIL

Under section 18 of the Act, any party to a dispute may, with regard to any amount due to him make a reference to the Micro and Small Enterprises Facilitation Council. On receipt of such reference the Council shall either itself conduct conciliation in the matter or seek the assistance of any institution or centre providing alternate dispute resolution services by making a reference to such an institution or centre, for conducting conciliation.

Where the conciliation initiated is not successful and stands terminated without any settlement between the parties, the Council shall either itself take up the dispute for arbitration or refer it to any institution or centre providing alternate dispute resolution services for such arbitration. The Micro and Small Enterprises Facilitation Council or the centre providing alternate dispute resolution services shall have jurisdiction to act as an Arbitrator or Conciliator in a dispute between the supplier located within its jurisdiction and a buyer located anywhere in India.

Every reference made under this section shall be decided within a period of 90 days from the date of making such a reference.

Section 19 of the MSMED Act, 2006 states that no application for setting aside any decree, award or other order made either by the Council itself or by any institution or centre providing alternate dispute resolution services to which a reference is made by the Council, shall be entertained by any court unless the appellant (not being a supplier) has deposited with it 75% of the amount in terms of the decree, award or, as the case may be.

Whereas pending disposal of the application to set aside the decree, award or order, the court shall order that such percentage of the amount deposited shall be paid to the supplier, as it considers reasonable under the circumstances of the case, subject to such conditions as it deems necessary to impose.

## Composition of Micro and Small Enterprises Facilitation Council

The Micro and Small Enterprise Facilitation Council shall consist of not less than 3 but not more than 5 members to be appointed from amongst the following categories, namely:

i. Director of Industries, by whatever name called, or any other officer not below the rank of such Director, in the Department of the State Government having administrative control of the small scale industries or, as the case may be, micro, small and medium enterprises; and
ii. one or more office-bearers or representatives of associations of micro or small industry or enterprises in the State; and
iii. one or more representatives of banks and financial institutions lending to micro or small enterprises; or
iv. one or more persons having special knowledge in the field of industry, finance, law, trade or commerce.

# Chapter 6 : Conversion of Business Entities

## INTRODUCTION

The provisions of the Companies Act, 2013 read with rules made thereunder provides for the conversions of various entities from one type of company to other another type of Company. However, in some case the company is mandatorily required for the conversion in to another type of Company.

Section 18 of the Companies Act, 2013 deals with conversion of companies already registered and provided that a company already registered in a class may convert itself as a company of another class by alteration of memorandum (section 13) and articles (section 14) of the company in accordance with the provisions of the Chapter II of the Companies Act, 2013.

An application in this regard is required to be made to Registrar. The Registrar after being satisfied that all provisions have been complied with, shall close the former registration of the company. After registering the documents relating to conversion, the Registrar shall issue a fresh certificate of incorporation for the converted entity. The conversion of a company shall not affect any debt, liabilities and obligations. Such debt, liabilities, obligation and contracts may be enforced as if there is no such conversion.

The company can convert into following type of companies:

- Conversion of a private company into a public company;
- Conversion of a public company into a private company;
- Conversion of One Person Company to private company/ public company;
- Conversion of private company to One Person Company;
- Conversion of section 8 company into any other kind;
- Conversion of unlimited liability company in to a limited liability company by share or guarantee;
- Conversion of a company limited by guarantee in to a company limited by shares;
- Conversion of Limited Liability Partnership into company;
- Conversion from private company into limited liability partnership;
- Conversion from unlisted public company into limited liability partnership;
- Incorporation of part XXI companies.

## CONVERSION OF A PRIVATE COMPANY INTO A PUBLIC COMPANY

The provisions related to conversion of private company into public company are provided under section 18 (conversion of companies already registered) and 14 (alteration of articles) of the Companies Act, 2013 read with Rule 33 of Companies (Incorporation) Rules, 2014.

Section 14 of the Companies Act, 2013 plays an important role during conversion of a private company into a public company. Conversion of a private company into a public company involves alteration of article of association of private company, which cannot be done without passing special resolution by the company in general meeting. The company shall have minimum of 7 members in the company.

The alteration of the articles of the private company shall be made in such a manner that they no longer include the restrictions and limitations which are required to be included in the articles of a private company i.e. minimum and maximum number of members, transfer of shares, number of directors, quorum of the general meeting etc., the company shall, as from the date of such alteration, cease to be a private company.

## Benefits of Conversion of Private Company into a Public Company:

Now a days the private companies which are planning for future expansion prefer to get it converted into public limited companies due to various benefits and growth opportunities available to the public companies. The main advantage of being a public company is access to capital fund. Public company can easily raise share capital from existing and new investors. Even the shareholders of public company have the benefit of liquidity of their investments as the shares of public limited company are freely transferable, if listed on stock exchange.

## Detailed Procedure for Conversion of a Private Limited Company into a Public Company:

1) **Holding a Board Meeting:** Issue a notice (not less than 7 days) and agenda of the Board Meeting as per the provisions of section 173 of the Companies Act and Secretarial Standards-I for convening a Board Meeting to consider the proposal for converting a Private Limited Company into Public Limited Company. The main agenda for this board meeting would be:

   a. To pass a board resolution to get in-principal approval of Directors for conversion of private company into a public company.

   b. To fix date, time and place for holding general meeting to get approval of shareholders, by way of Special Resolution, for conversion of a Private company into a Public company.

   c. To approve notice of general meeting along with agenda and explanatory statement to be annexed to the notice of general meeting as per section 102(1) of the Companies Act, 2013. The notice of general meeting must contain the special resolution for effecting the conversion of private limited company into public limited company and the required alteration in the Memorandum of Association and Articles of Association of the Company.

   d. To authorize the Director or Company Secretary to issue notice of the general meeting as approved by the board.

   e. Pass Board resolution for increase in number of Directors, if Directors are less than 3 in the company.

   f. To authorize the Company Secretary and if there is no Company Secretary, any one director of the company to sign, certify and file the required forms with the Registrar of Companies and to do all such acts and deeds necessary to give effect to the proposed conversion.

   g. To approve the draft new set of Memorandum of Association and the Articles of Association meeting the requirement of a Public Limited Company.

2) **Issue of Notice of General Meeting:** Issue Notice of the General meeting to all Members, Directors and the Auditors of the company in accordance with the provisions of Section 101 of the Companies Act, 2013 and Secretarial Standards -2. Notice shall be given atleast 21 clear days before the actual date of General Meeting. Shorter notice can be issued if the consent of majority of shareholders holding 95% of paid-up capital has been obtained. Notice shall specify the day, date, time and full address of the venue of the General Meeting and must contain a statement on the business to be transacted at such Meeting.

3) **Holding of General Meeting:** Hold the General meeting as scheduled and pass the necessary Special Resolution, to get shareholders' approval for Conversion of Private Company into a Public company along with alteration in Memorandum of Association and Articles of Association under section 14 for such conversion including the removal of restrictive provisions as applicable to the private limited company and for change of name of the company to delete the word "private".

4) **Filing of e-form MGT-14:** In case of conversion of Private Company into a Public Company Special resolution is required to be passed under section 14 of the Companies Act, 2013. Accordingly as per section 117(3)(a), a copy of special resolution is required to be filed with concerned ROC through filing of E-form MGT-14 within 30 days of passing special resolution in the general meeting. Following documents are required to be attached with e-form MGT-14:

   a. Notice of general meeting along with copy of explanatory statement under section 102;

   b. Certified true copy of special resolution;

   c. Altered memorandum of association;

   d. Altered articles of association

   e. Certified true copy of board resolution may be attached as an optional attachment.

5) **Filing of e-form INC-27:** For giving effect to conversion of Private Company into Public Company, an application in E-Form INC-27 needs to be filed with the Registrar of Companies along with prescribed fees within fifteen days of passing of Special Resolution as per Rule 33 of Companies (Incorporation) Rules, 2014. Following documents are required to be attached with e-form INC-27:

   (i) It is mandatory to attach minutes of the member's meeting where approval was given for conversion and altered articles of association;

   (ii) Certified True Copy of Special Resolution;

   (iii) Altered articles of association;

   (iv) Certified True Copy of Special Resolution;

   (v) Certified true copy of board resolution may be attached as an optional attachment;

   (vi) Other information if any can be provided as an optional attachment(s).

6) **Scrutiny of documents by ROC and issuance of fresh Certificate of Incorporation:**

As per Section 18, for conversion of a private company into a public company, the Registrar shall on an application made by the company and on the approval of E-Form MGT-14 and E-Form INC-27, after satisfying himself that the provisions of Chapter II of the Companies Act, 2013 applicable for registration of companies have been complied with, close the former registration of the company and after registering the documents, issue a certificate of incorporation in the same manner as its first registration.

## Post Conversion requirements to be arranged by the company

Once the company gets converted into public limited company, it needs to intimate and inform some authorities, persons as required by law. Following are the major compliance that needs to be followed by the company after conversion:

- A fresh PAN card has to be applied to reflect the conversion done.
- The bank account details of the company needs to be updated.
- Proper intimation needs to be given to tax authorities and other regulatory authorities about the conversion.
- Every alteration made in the memorandum or articles of a company shall be noted in every copy of the memorandum or articles, as the case may be.
- A fresh rubber stamp is required to be arranged with the new name of the Company.
- Paint or affix or print, new name along with the former name so changed on the outside of every office.
- Inform about the conversion from private limited to public limited to various Government authorities like GST department, Regional Provided Fund department, Income tax department, etc.
- Intimate all the banks where the current accounts of the company are opened about the conversion with regard to change in the name and status of the Account holder.

## CONVERSION OF A PUBLIC COMPANY INTO A PRIVATE LIMITED

Section 13, 14, 15 & 18 of the Companies Act, 2013, Rule 33(2) the Companies (Incorporation) Rules, 2014 regulate the conversion of public company into private company. Conversion of status of company from public to private would become effective form the date of receipt of the approval of the Registrar by means of issuing a new certificate of Incorporation.

As per Section 13 and Section 14 of the Companies Act 2013 read with Rule 33 of the Companies (Incorporation)

Rules, 2014. A public company can be converted into the private company only after obtaining its shareholders' approval by way of passing of special resolution in general meeting.

For conversion of public company into private company foremost requirement is Alteration in Article of Association of Company. According to the Act, any alteration having the effect of conversion of a public company into a private company shall not be valid unless it is approved by an order of the Regional Director.

For effecting the conversion of a public company into a private company, a copy of order of the Regional Director approving the alteration, shall be filled with the Registrar in Form No. INC -27 with fee together with the printed copy of altered articles within fifteen days from the date of receipt of the order from the Regional Director.

At the time of Conversion Company have to make several alterations. Some of them are mentioned below:

- Change of Name;
- Alteration of Memorandum of Association;
- Alteration of Article of Association;
- New Certificate of Incorporation;
- Alteration of Letter head, book & papers.

**Detailed Procedure for Conversion of a Public Limited Company into a Private Company:**

1) **Holding a Board Meeting:** Issue a notice (not less than 7 days) and agenda of the Board Meeting as per the provisions of section 173 of the Companies Act and Secretarial Standards-I for convening a Board Meeting to consider the proposal for converting a Public Limited Company into Private Limited Company. The main agenda for this board meeting would be:

   a. To pass a board resolution for approving proposal of conversion of Public Company into a Private Company, and to recommend the proposal for conversion for approval of shareholders in the General Meeting of the Company.

   b. To fix date, time and place for holding general meeting to get approval of shareholders, by way of Special Resolution, for conversion of a Public company into a Private company.

   c. To approve notice of general meeting along with agenda and explanatory statement to be annexed to the notice of general meeting as per section 102(1) of the Companies Act, 2013. The notice of general meeting must contain the special resolution for effecting the conversion of public limited company into private limited company and the required alteration in the Memorandum of Association and Articles of Association of the Company.

   d. To authorize the Director or Company Secretary to issue notice of the general meeting as approved by the board.

   e. Pass Board resolution for considering and approving the reduction in the total number of members of the company to a maximum of 200 members.

   f. To authorize the Company Secretary and if there is no Company Secretary, any one director of the company to sign, certify and file the required forms with the Registrar of Companies and to do all such acts and deeds necessary to give effect to the proposed conversion.

   g. To approve the draft new set of Memorandum of Association and the Articles of Association meeting the requirement of a Private Limited Company.

2) **Issue of Notice of General Meeting:** Issue Notice of the General meeting to all Members, Directors and the Auditors of the company in accordance with the provisions of Section 101 of the Companies Act, 2013 and Secretarial Standards -2. Notice shall be given atleast 21 clear days before the actual date of General Meeting. Shorter notice can be issued if the consent of majority of shareholders holding 95% of paid-up capital has been obtained. Notice shall specify the day, date, time and full address of the venue of the General Meeting and must contain a statement on the business to be transacted at such Meeting.

3) **Holding of General Meeting:** Hold the General meeting as scheduled and pass the necessary Special Resolution, to get shareholders' approval for Conversion of Public Limited Company into a Private Limited company along with alteration in Memorandum of Association and Articles of Association under section 14 for such conversion including insertion of restrictive provisions as applicable to the private limited company and for change of name of the company to insert the word "private".

4) **Filing of e-form MGT-14:** In case of conversion of Public Company into a Private Company Special resolution is required to be passed under section 14 of the Companies Act, 2013. Accordingly as per section 117(3)(a), a copy of special resolution is required to be filed with concerned ROC through filing of E-form MGT-14 within 30 days of passing special resolution in the general meeting. Following documents are required to be attached with e-form MGT-14:

   a) A certified true copy of Altered MoA;
   b) A certified true copy of Altered AoA;
   c) Notice of General Meeting along with an explanatory statement;
   d) Certified true certified copy of Special Resolutions passed in General Meeting along with explanatory statement.

5) **Publication of an Advertisement:** The Company shall, at least twenty-one days before the date of filing of the application with Regional Director must advertise an application for conversion of public limited company into private limited company in a vernacular newspaper in the district, and in English newspaper, which is circulated widely in the State in which the Registered Office of the Company is situated as per Rule 41(5) of the Companies (Incorporation) Rules, 2014. The application should be advertised in Form INC-25A. The Company shall also serve the individual notice by registered post with acknowledgement due to each of the Creditors and debenture holders of the company and to the RD, Registrar of Companies and the regulatory body for the same.

6) **File an Application with the Regional Director for Conversion of Public Company into Private Company:** The Company must draft an application for the conversion of Public Company into Private Company and file the same with the Regional Director within sixty days from the date of passing of Special Resolution in e-Form RD-1 along with the prescribed fee as per Rule 41(1) and 41(3) of the Companies (Incorporation) Rules, 2014. The form needs to be filed along with the following annexures:

   a. Draft copy of altered Memorandum of Association and Articles of Association, with proposed alterations including the alterations pursuant to Section 2(68).

b. Copy of minutes of General Meeting.

c. Copy of Board resolution dated not earlier than thirty days authorizing to file application for such conversion.

d. Declaration by a Key Managerial Personnel that pursuant to the provisions of Section 2(68) of the Companies Act, 2013 that the company limits the number of its members to 200 and also stating that no deposit has been accepted by the Company in violation of the Act and rules made thereunder.

e. Declaration by a Key Managerial Personnel that there has been no non-compliance of sections 73 to 76A, 177 , 178, 185, 186 and 188 of the Act and rules made thereunder.

f. Declaration by a Key Managerial Personnel and in case if there is no KMP, by any director of the company, that no resolution is pending to be filed in terms of sub-section (3) of section 179 and also stating that the Company was never listed in any of the Stock Exchanges and if was so listed, all necessary procedures were complied with for complete delisting of the shares in accordance with the applicable rules and regulations laid down by Securities Exchange Board of India.

g. List of Creditors and Debenture Holders of a date not more than 30 days before the date of filing of Application with Regional Director along with the name and address of creditors and debenture holders, the nature of claims, debts and liability with amount due and in respect of any contingent or unascertained debt, the estimated value of such debt.

h. An affidavit signed by the Company Secretary of the company, if any, and not less than twodirectors of the company, one of whom shall be managing director, where there is one, to the effect that full enquiry have been made into affairs of the company and have formed an opinion that the list of creditors and debenture holders is correct, and that the estimated value of the debts or claims payable on contingency or not ascertained are proper estimates of the values of such debts and claims that there are no other debts, or claims against, the company to their knowledge.

7) **Approval of Application for conversion by Regional Director or seeking of further information, if required, by Regional Director:** Where no objection has been received from any person in response to the advertisement or notice published in the newspaper and the application is complete in all respects, the concerned Regional Director shall pass an order approving the application within 30 days from the date of receipt of the application as per Rule 41(6)(a) of the Companies (Incorporation) Rules, 2014.But where an objection has been received by the Regional Director or Regional Director on examining the application has specific objection under the provisions of the Act, the same shall be recorded in writing and shall hold a hearing/hearings within a period of 30 days as required and direct the company to file an affidavit to record the consensus reached at the hearing, upon executing which, the Regional Director shall pass an order either approving or rejecting the application along with the reasons within 30 days from the date of hearing.

In case where no consensus is received, the Regional Director may approve the conversion, if he is satisfied having regard to all the circumstances of the case, that the conversion would not be against the interests of the company or is not being made with a view to contravene the provisions of the Act, with reasons to be recorded in writing.

Where the Regional Director on examining the application finds it necessary to call for further information or finds such application to be defective or incomplete in any respect, he shall within 30 days from the date of receipt of the application, call for such information or defects or incompleteness, directing the company to furnish such information, to rectify defects or incompleteness and to re-submit such application within a period of 15 days in e-Form RD-GNL-5. In cases where such further information called for has not been provided or the defects or incompleteness has not been rectified to the satisfaction of the Regional Director within 15 Days, the Regional Director shall reject the application with reasons within 30 days from the date of filing application or within 30 days from the date of last re-submission made, as the case may be.

8) **Filing of e-form INC-28 with the Registrar of Companies:** Company shall file the order conveyed by the Regional Director with the Registrar in Form INC-28 within 15 days from the date of receipt of approval as per Rule 41(9) of the Companies (Incorporation) Rules, 2014 along with the prescribed fee.

9) **Filing of e-form INC-27 with the Registrar of Companies:** Company shall file the copy of order approving the alteration of article along with the certified true copy of altered articles with the Registrar of Companies in Form INC -27 along with the prescribed fee together within 15 days from the date of receipt of the order.

10) **Issuance of fresh Certificate of Incorporation:** The Registrar on the approval of E-Form MGT-14 and E-Form INC-27, after satisfying himself that the provisions applicable for conversion of companies have been complied with, close the former registration of the company and after registering the documents, issue a fresh certificate of incorporation in the same manner as its first registration.

**Points to ponder:**

- Name clause of Memorandum needs to be amended to include the word 'Private'.
- The Articles of Association should be amended to include the restrictive provisions applicable to the Private Company.
- Company has not defaulted in filing of Annual Returns or financial Statement due for filing with the Registrar.
- Company has not failed to pay or repay matured deposits or debentures or interest thereon.
- Reduce in the total number of members of the company to a maximum of 200 members.

## Post Conversion requirements to be arranged by the company

Once the company gets converted into private limited company, it needs to intimate and inform some authorities, persons as required by law. Following are the major compliance that needs to be followed by the company after conversion:

- Arrange new rubber stamps with the new name, and all the stationary in the new name of the Company.
- Arrange printing of fresh copies of Altered Memorandum of Association and Articles of Association with new Certificate of Incorporation.
- Paint the new name of the Company outside every office, building etc. along with former name so changed.
- Get the new name printed on its business letters, letter heads, Bill heads, Invoice Forms, Receipt Forms and all other official publications along with former name so changed.
- Inform about the conversion of the Company to all concerned persons/ govt. authorities.
- Intimate all the Banks where Company is operating Bank Accounts about its conversion and file necessary applications and documents with regard to change in the name of Account holder.
- Make application to Income Tax Department for new Permanent Account Number (PAN) and Tax Deduction and Collection Account Number (TAN).

## CONVERSION OF SECTION 8 COMPANY INTO OTHER KIND OF COMPANY

Section 8(4)(ii) of the Companies Act, 2013 provides that a company registered under Section 8 may convert itself into company of any other kind only after complying with such conditions as may be prescribed.

Detailed Procedure for Conversion of a Section 8 Company into any other Company:

1) **Holding a Board Meeting:** Issue a notice (not less than 7 days) and agenda of the Board Meeting as per the provisions of section 173 of the Companies Act and Secretarial Standards-I for convening a Board Meeting to consider the proposal for converting Section 8 Company into any other Company. The main agenda for this board meeting would be:

   a. To pass a board resolution to get in-principal approval of Directors for conversion of section 8 company into any other company.

   b. To fix date, time and place for holding general meeting to get approval of shareholders, by way of Special Resolution, for conversion of a section 8 company into any other company.

   c. To approve notice of general meeting along with agenda and explanatory statement to be annexed to the notice of general meeting as per section 102(1) of the Companies Act, 2013. The notice of general meeting must contain the special resolution for effecting the conversion of section 8 Company into any other company and the required alteration in the Memorandum of Association and Articles of Association of the Company.

   d. To authorize the Director or Company Secretary to issue notice of the general meeting as approved by the board.

   e. To authorize the Company Secretary and if there is no Company Secretary, any one director of the company to sign, certify and file the required forms with the

Registrar of Companies and to do all such acts and deeds necessary to give effect to the proposed conversion.

f. To approve the draft new set of Memorandum of Association and the Articles of Association.

2) **Issue of Notice of General Meeting:** Issue Notice of the General meeting to all Members, Directors and the Auditors of the company in accordance with the provisions of Section 101 of the Companies Act, 2013 and Secretarial Standards -2. Notice shall be given atleast 14 clear days' before the actual date of General Meeting. Notice shall specify the day, date, time and full address of the venue of the General Meeting and must contain a statement on the business to be transacted at such Meeting.

3) **Holding of General Meeting:** Hold the General meeting as scheduled and pass the necessary Special Resolution, to get shareholders' approval for Conversion of Section 8 Company into any other Company along with alteration in Memorandum of Association and Articles of Association under section 14.

4) **Filing of e-form MGT-14:** In case of conversion of Section 8 Company into any other company special resolution is required to be passed under section 14 of the Companies Act, 2013. Accordingly as per section 117(3)(a), a copy of special resolution is required to be filed with concerned ROC through filing of E-form MGT-14 within 30 days of passing special resolution in the general meeting. Following documents are required to be attached with e-form MGT-14:

- A certified true copy of Altered MoA.
- A certified true copy of Altered AoA.
- Notice of General Meeting along with an explanatory statement.
- Certified true certified copy of Special Resolutions passed in General Meeting along with explanatory statement.

5) **Filing of e-form INC-18 with the Regional Director and Registrar:** The Company shall file an application in Form No.INC.18 with the Regional Director along with the prescribed fees for conversion of section 8 company into private limited company along with the following attachments: –

- A certified true copy of the special resolution.
- A copy of the Notice convening the meeting including the explanatory statement for approval for converting itself into a company of any other kind.
- The proof of serving of the notice served to all the authorities (Chief Commissioner of Income Tax having jurisdiction over the company, Income Tax Officer who has jurisdiction over the company, the Charity Commissioner, the Chief Secretary of the State in which the registered office of the company is situated, any organisation or Department of the Central Government or State Government or other authority under whose jurisdiction the company has been operating).

A copy of the application with annexures as filed with the Regional Director shall also be filed with the Registrar.

6) **Publication of an Advertisement:** After submitting an application to the Regional Director, the Company should publish a notice in FORM INC-19 in the newspaper at least one in a vernacular newspaper in the principal vernacular language of the district in which the registered office of the company is situated, and having a wide circulation in that district, and at least once in English language in an English newspaper having a wide circulation in that district, for the Conversion of Section 8 Company into any other Company and on the website of the company, if any. The publication in the newspaper should be done within a week from the date of submitting an application to the Regional Director.

7) **Order of Conversion by Regional Director:** On receipt of application and on being satisfied, the Regional Director shall pass the order of conversion with certain conditions, as may be required depending upon the facts and circumstances of each case. However, before imposing any conditions or rejecting the application, the Regional Director shall give a reasonable opportunity of being heard to the Company.

8) **Issuance of fresh Certificate of Incorporation:** On receipt of all the required documents, the Registrar of Companies will Issue Fresh Certificate of Incorporation to the applicant. When the license of Company as Section 8 Company is revoked, the Company can apply for the Conversion of its status and name with the Registrar of Companies in Form INC-20.

**Points to ponder:**

- The Company has not transferred any part of the Income or property of the Company by way dividend or bonus or otherwise.
- Company has not defaulted in filing of Annual Returns or financial Statement due for filing with the Registrar.
- No objection certificate is required in case where the Company has obtained any special status, privilege, exemption, benefit or grant(s) from any authority or from Government.

**Effect of conversion of Section 8 Company into Private Company**

- The Company cannot claim the privileges and exemptions as enjoyed by Section 8 Company after the conversion.
- The newly converted Company has to pay the difference between the balance of market price and purchase price, if before the Conversion the Company has bought any immovable property from the Government at lower rates than the market price.
- Where the Company is left with some unutilized income and accumulated profits which are brought forward from the previous year the same should be utilized for the purpose of settlement of outstanding dues or any amount due to suppliers or creditors.
- After settlement of all the dues, if any amount is left, it will be transferred to the Investor Education & Protection Fund. The amount should be transferred within 30 days of the Conversion of Section 8 Company into other form of Company.

## CONVERSION OF COMPANY INTO LLP

Any existing private company or existing unlisted public company can be converted into LLP by complying with the Provisions of clause 58 and Schedule III and IV of the LLP Act.

Before proceeding for conversion of company into Limited Liability Partnership one needs to confirm regarding certain pre-conditions and once all these conditions are fulfilled, the process for conversion of company into Limited Liability Partnership can be initiated.

**Conditions to fulfill for conversion:**

- All members/directors will become the partners of the newly converted LLP
- All statutory compliances have been fulfilled including Income tax returns, RoC returns, etc. up-to-date
- Creditors must agree for the conversion
- No prosecution or pending cases against the company proposing to convert
- There should be no pending E-Forms of a company
- There should be no open charges for or against the Company.

**Detailed Procedure for Conversion of Company into Limited Liability Partnership:**

1) **Holding a Board Meeting:** Issue a notice (not less than 7 days) and agenda of the Board Meeting as per the provisions of section 173 of the Companies Act and Secretarial Standards-I for convening a Board Meeting to consider the proposal for converting Company into Limited Liability Partnership. The main agenda for this board meeting would be:
   a. To pass a board resolution to get in-principal approval of Directors for conversion of Company into Limited Liability Partnership.
   b. To fix date, time and place for holding general meeting to get written approval of shareholders, by way of Special Resolution, for conversion of Company into Limited Liability Partnership.
   c. To authorize the Director to issue notice of the general meeting as approved by the board. Before conducting board meeting obtain DIN for all those designated partners who don't have DIN already.
2) **Holding of General Meeting:** Hold the General meeting as scheduled and pass the necessary Special Resolution, to get shareholders' written approval for Conversion of Company into Limited Liability Partnership.
3) **Application for Name Availability on LLP Portal:** The Company must apply for a name reservation, by filing web based form 'RUN-LLP' with ROC along with the board resolution passed by the Company approving the conversion into LLP and obtain Name Approval Letter from ROC.

4) **Filing of incorporation documents in LLP Portal:** Once the Company reserves its name, LLP must file its incorporation in web based form FiLLip (Filing of Form of Incorporation) with ROC along with the belowmentioned documents:
   - Proof of Address of Registered office of LLP
   - Subscription sheet signed by the promoters
   - Latest Utility bill of registered office
   - NOC of owner of registered office, if taken on rent / lease
   - Notice of Consent & Appointment of Designated Partners with their personal details
   - Detail of LLP(s) and/ or company(s) in which partner/ designated partner is a director/ partner

5) **Application for Conversion of company into LLP**: For converting the existing Company into LLP, FiLLip Form 18 must be duly filled. The following information is required to be furnished along with the form 18:
   - Statement of shareholders
   - Incorporation Documents & Subscribers Statements
   - Statement of Assets and Liabilities of the company duly certified as true and correct by the auditor
   - List of all the Secured creditors along with their consent to the conversion
   - NOC from Income Tax authorities and Copy of acknowledgement of latest income tax return
   - Approval from any other body/authority as may be required
   - Particulars of pending proceedings from any court/Tribunal etc.

6) **Drafting of limited liability partnership agreement:** After the incorporation, the designated partners must enter into an LLP agreement in prescribed format. It is not necessary to have the LLP Agreement signed at the time of incorporation, as the details of the same needs to filed in e-form 3 within 30 days of incorporation along with the Certificate of incorporation as LLP form ROC but in order to avoid any dispute between the partners as to the terms & conditions of the agreement the same can be filed afterwards. The contents of limited liability partnership agreement are as follows:
   - Name of LLP
   - Name of Partners & Designated Partners
   - Form of contribution
   - Profit Sharing ratio
   - Rights & Duties of Partners
   - Proposed Business
   - Rules for governing the LLP

7) **Issuance of fresh Certificate of Incorporation:** After all formalities and filings been complied with by the applicants and approved by the Ministry, Registrar of LLP will issue a Certificate of Registration in Form no. 19 as to conversion of the LLP. The Certificate of Registration issued shall be the conclusive evidence of conversion of the LLP.

## Effect of Conversion from Company to LLP:

- The Company gets dissolved after conversion.
- Registrar of Company will remove the name of Company from the register of Companies maintained with it.
- Conversion does not affect present liability, obligation, agreements and contracts.
- On conversion of Company into LLP, assets of the Company will be transferred to LLP. There is no requirement of instrument of transfer. Hence, no stamp duty implication is required for such transfer.
- After conversion into LLP there is no requirement for holding minimum number of meetings as prescribed by the Companies Act, 2013.

## CONVERSION OF LLP INTO COMPANY

Several businesses started in India as Limited Liability Partnership (LLP), may now wish to convert into a private limited company for more growth in business or for infusing equity capital. The entire world is gradually drifting towards one global market without any trade barriers between the countries. With the emergence of corporate work culture and promotional startup benefits, a great chunk of entrepreneurs are looking forward to corporatization. This step can be initiated in 2 ways as enumerated below:

(i) Incorporation of a new corporate entity.

(ii) Conversion of existing entity (e.g. LLP/ Partnership Firm) into a Company.

The second option of conversion of Limited Liability Partnership into a corporate entity might be practical for the existing entities to switch over from one mode of business to another. The process of conversion is a step by step procedure, which is a technical process but if handled with expert knowledge may be time and cost saving, as well.There were no provisions under Companies act, 2013 regarding Conversion of Limited Liability Partnership into Company. Ministry of Corporate Affairs has passed a notification on 31st May, 2016 in such notification conversion of LLP into Company is allowed. These rules called as "the Companies (Authorized to Register) Amendment Rules, 2016.

However, there are various requirements which need to be satisfied for converting an LLP into a Private Limited Company, for instance, an LLP must have at least 7 partners (however as per Companies Amendment Act, 2017 LLP with 2 partners can be convert into Company), approval from all the partners is required, advertisement in newspaper is to be done in a local and a national newspaper, a No Objection Certificate (NOC) is required from the ROC where such LLP is registered and then all the incorporation process has to be undertaken which includes:

## Detailed Procedure for Conversion of Limited Liability Partnership into a Company:

1) **Approval of Name:** Hold a meeting of the partners to take assent of majority of its members summoned for the purpose of registering the LLP under Section 366 of the Companies Act, 2013.To authorize one or more partners to take all steps necessary and to execute all papers, deeds, documents etc. pursuant to registration of the LLP as a Company. One of the major advantages is that the business can be run under the same name as that of the LLP except that in addition to the name of the LLP the words 'limited' or 'private limited' has to be added. Apply for name reservation in form RUN in V3 portal. It is a web based form.

2) **Securing DSC and DIN:** In case all members, who are future directors of the company after conversion, do not have the Digital Signature Certificate (DSC) and Director Identification Number (DIN) for all the future directors of the company must be obtained. For obtaining the DIN, an application form must be filed on MCA portal. DIN application is processed & approved by central government via the office of regional director, the ministry of corporate affairs. The form must be accompanied by self-attested address proof and identity proof with 1 recent passport size color photo of the applicant. All the required documents should be attested by a practicing cost accountant or a practicing chartered accountant or a practicing company secretary.

3) **Filing form no. URC – 1:** After getting the approval of name from Registrar of Companies, the applicant must prepare & file the form no. URC-1 in addition to the following documents:

- List of the members with various details viz. names, address, shares held by them appropriately, etc.
- List of the first directors of the private company with various details viz. names, address, the DIN, passport number with an expiry date, etc.
- An affidavit from every person proposed as first directors, that he is not banned to be a director under section-164 and all the necessary documents filed with the registrar for the registration of firm must contain information which is complete and correct & true to be best of his belief and knowledge.
- A list including the names & addresses of partners of LLP and a copy of LLP agreement & certificate of registration duly verified by two designated partners of LLP must be enclosed.
- A statement indicating the following specifications.
- The nominal share capital of firm & the number of shares into which it is separated.
- The number of shares taken & the amount paid for every share.
- The name of the firm, with the addition of word Limited or private limited is required.
- A written consent or No objection certificate from all creditors.

- Copy of newspaper advertisement, statement of accounts of the company which must not be 6 days preceding the date of the application and it must be duly certified by the auditor.
  - Written consent, from the majority of members whether present in person or by proxy at a general meeting, agreeing for such registration;
  - an undertaking that the proposed directors shall comply with the requirements of the Indian Stamp Act, 1899 as applicable;
  - A copy of the latest income tax return of the Limited Liability Partnership or firm, as the case may be.

In case of an application by a Limited Liability Partnership or firm for registration as a company limited by guarantee or as an unlimited company-

(i) a list showing the names, addresses and occupations of all persons, who on a day, not being more than six clear days before the day of seeking registration, were partners of the Limited Liability Partnership or firm, as the case may be with proof of membership;

(ii) a list showing the particulars of persons proposed as the first directors of the company, along with DIN, passport number, if any, with expiry date, residential addresses and their interests in other firm or body corporate along with their consent to act as directors of the company;

(iii) in case of a firm, deed of partnership, bye laws or other instrument constituting or regulating the company and in case the deed of partnership was revised at any time in the past, copies of the principal and all subsequent deeds including the latest deed, along with the certificate of the registration issued by the Registrar of Firms, in case the firm is registered;

(iv) in the case of a company intended to be registered as a company limited by guarantee, a copy of the resolution declaring the amount of guarantee;

(v) written consent or No Objection Certificate from all the secured creditors of the applicant;

(vi) written consent from the majority of members whether present in person or by proxy at a general meeting agreeing for such registration;

(vii) an undertaking that the proposed directors shall comply with the requirements of the Indian Stamp Act, 1899 (2 of 1899), as applicable;

(viii) A copy of the latest income tax return of the Limited Liability Partnership or firm, as the case may be.

4) **Filing of SPICe, SPICe MOA and SPICe AOA:** Similar to incorporation of new company, the process has to be followed by filing SPICe + form along with required attachments for the converted entity.

**Conditions to fulfill for conversion:**

- All the partners should have approved the conversion of LLP.
- The LLP should have complied with all the required returns and compliances.

- Publication related to such conversion of LLP into a Private Company, in at least two newspapers, one in English Language and another in any vernacular language newspaper of the place of registered office.
- The Limited Liability Partnership must have at least two partners who are required for incorporation of a Private Limited company.
- There should be no open charges for or against the Company.

**Points to ponder:**

- There is no capital gain tax in a private limited company.
- Existing LLP has just been replaced by the Private Limited Company by adding the "Pvt. Ltd." at the end of its name.

## CONVERSION OF ONE PERSON COMPANY INTO A PUBLIC COMPANY OR A PRIVATE COMPANY

One Person Company (OPC) refers to a form of company that has only one person as a member, unlike a private company where the minimum number of members are two or a public company where the minimum number of members are seven. Section 18 of the Companies Act, 2013 read with Rule 6 of the Companies (Incorporation)

Rules, 2014, explicitly provide provisions for the voluntary conversion of One Person Company (OPC) to other forms of the Company, as the case may be.

When conversion is necessary into a Private Company or Public Company

**1)** The One Person Company shall alter its memorandum and articles by passing a resolution in accordance with section 122(3) of the Act to give effect to the conversion and to make necessary changes incidental thereto.

**2)** A One Person Company may be converted into a Private or Public Company, other than a company registered under section 8 of the Act, after increasing the minimum number of members and directors to two or seven members and two or three directors, as the case may be, and maintaining the minimum paid-up capital as per the requirements of the Act for such class of company and by making due compliance of section 18 of the Act for conversion.

**3)** The company shall file an application in e-Form No.INC-6 for its conversion into Private or Public Company, other than under section 8 of the Act, along with fees as provided in the Companies (Registration offices and fees) Rules, 2014 by attaching documents, namely: -

(a) Altered MOA and AOA;

(b) copy of resolution;

(c) the list of proposed members and its directors along with consent;

(d) list of creditors; and

(e) the latest audited balance sheet and profit and loss account.

**4)** On being satisfied that the requirements stated herein have been complied with, the Registrar shall approve the form and issue the Certificate.

## Detailed Procedure for Conversion of OPC into company:

1) **Holding of Board Meeting:** Issue a notice (not less than 7 days) and agenda of the Board Meeting as per the provisions of section 173 of the Companies Act and Secretarial Standards-I for convening a Board Meeting to consider the proposal for converting a One Person Company into Other Company.

   The main agenda for this board meeting would be:

   a. To pass a board resolution to get in-principal approval of Directors for conversion of One Person company into other company.

   b. To fix date, time and place for holding general meeting to get approval of shareholders, by way of Special Resolution, for conversion of One Person Company into other company.

   c. To approve notice of general meeting along with agenda and explanatory statement to be annexed to the notice of general meeting as per section 102(1) of the Companies Act, 2013. The notice of general meeting must contain the special resolution for effecting the conversion of One Person Company into other company and the required alteration in the Memorandum of Association and Articles of Association of the Company.

   d. To authorize the Director or Company Secretary to issue notice of the general meeting as approved by the board.

   e. Pass Board resolution for increase in number of Directors as per the type of company chosen for conversion.

   f. To authorize the Company Secretary and if there is no Company Secretary, any one director of the company to sign, certify and file the required forms with the Registrar of Companies and to do all such acts and deeds necessary to give effect to the proposed conversion.

   g. To approve the draft new set of Memorandum of Association and the Articles of Association meeting the requirement of a Public Limited Company.

2) **Issue of Notice of General Meeting:** Issue Notice of the General meeting to all Members, Directors and the Auditors of the company in accordance with the provisions of Section 101 of the Companies Act, 2013 and Secretarial Standards -2. Notice shall be given atleast 21 clear days before the actual date of General Meeting. Notice shall specify the day, date, time and full address of the venue of the General Meeting and must contain a statement on the business to be transacted at such Meeting.

3) **Holding of General Meeting:** Hold the General meeting as scheduled and pass the necessary Special Resolution, to get shareholders' approval for One Person Company into Other Company along with alteration in Memorandum of Association and Articles of Association under section 14 for such conversion.

4) **Filing of e-form MGT-14:** In case of conversion of One Person Company into Other Company Special resolution is required to be passed under section 14 of the Companies Act, 2013. Accordingly as per section 117(3)(a), a copy of special resolution is required to be filed with concerned ROC through filing of E-form MGT-14 within 30 days of passing special resolution in the general meeting. Following documents are required to be attached with e-form MGT-14:

   a. Notice of general meeting along with copy of explanatory statement under section 102;

   b. Certified true copy of special resolution;

   c. Altered memorandum of association;

   d. Altered articles of association;

   e. Certified true copy of board resolution may be attached as an optional attachment.

5) **Filing of e-form INC-6**: The One Person Company (OPC) shall file an application in Form No. INC 6 within 30 days of passing resolution of conversion, along with the fees prescribed in the Companies (Registration offices and fees) Rules, 2014 and the following documents:

   a. Altered Memorandum of Association and Articles of Association

   b. Copy of Special Resolution along with explanatory statement

   c. List of the proposed members and its directors together with their consent

   d. List of creditors

   e. Copy of latest duly attested financial statements that is audited balance sheet and profit and loss account

   f. Declaration by way of affidavit of Directors duly sworn in confirming that all members and creditors of the company have given their consent for conversion.

6) **Issuance of New Certificate of Incorporation:** On approval of Form MGT-14 and Form INC-6, the Registrar will issue a fresh Certificate of Incorporation with the Changed name to the applicant company in Form INC-25.

**Conditions to fulfill for conversion:**

- Alteration of Memorandum of Association and Articles of Association in accordance with Section 122(3) of the Companies Act, 2013 to give effect to the conversion.
- Increase the minimum number of directors to two or three as the case may be.
- Increase the minimum number of members to two or seven as the case may be.
- Due compliance with the provisions of section 18 of the Companies Act, 2013.

**Points to ponder:**

- A minor shall not become a member or nominee of the One Person Company.
- A minor can't hold shares with beneficial interest into One Person Company.
- One Person Company can't be incorporated or converted into a Section 8 company.

- One Person Company can't carry out Non-Banking Financial Investment activities including investment in securities of any Body corporates.

## CONVERSION OF COMPANY INTO ONE PERSON COMPANY

Legal Provisions related to Conversion of Private Company into OPC are given in Section 18 the Companies Act, 2013 read with Rule 7 of Companies (Incorporation) Rules, 2014. One Person Company (OPC) can be easily managed with very fewer compliances to be followed as compared to other form of Company. The Conversion of Private Company into OPC will benefit most people associated with the Company.

## Detailed Procedure for Conversion of company into OPC:

1) **Holding of Board Meeting:** Issue a notice (not less than 7 days) and agenda of the Board Meeting as per the provisions of section 173 of the Companies Act and Secretarial Standards-I for convening a Board Meeting to consider the proposal for converting a Company into One Person Company. The main agenda for this board meeting would be:
   a. To pass a board resolution to get in-principal approval of Directors for conversion of a Company into One Person Company.
   b. To fix date, time and place for holding general meeting to get approval of shareholders, by way of Special Resolution, for conversion of a Company into One Person Company.
   c. To approve notice of general meeting along with agenda and explanatory statement to be annexed to the notice of general meeting as per section 102(1) of the Companies Act, 2013. The notice of general meeting must contain the special resolution for effecting the conversion of a Company into One Person Company and the required alteration in the Memorandum of Association and Articles of Association of the Company.
   d. To authorize the Director to issue notice of the general meeting as approved by the board.
   e. To authorize the director of the company to sign, certify and file the required forms with the Registrar of Companies and to do all such acts and deeds necessary to give effect to the proposed conversion.
   f. To approve the draft new set of Memorandum of Association and the Articles of Association meeting the requirement of One Person Company.
2) **Issue of Notice of General Meeting:** Issue Notice of the General meeting to all Members, Directors and the Auditors of the company in accordance with the provisions of Section 101 of the Companies Act, 2013 and Secretarial Standards -2. Notice shall be given atleast 21 clear days before the actual date of General Meeting. Notice shall specify the day, date, time and full address of the venue of the General Meeting and must contain a statement on the business to be transacted at such Meeting.
3) **Holding of General Meeting:** Hold the General meeting as scheduled and pass the necessary Special Resolution, to get shareholders' approval for Conversion of Company into One Person Company along with alteration in Memorandum of Association and Articles of Association under section 14 for such conversion. Before passing the Special

Resolution in the General Meeting, the Company should get a No Objection Certificate (NOC) in writing from the existing shareholders and creditors.

4) **Filing of e-form MGT-14:** In case of conversion of Company into One Person Company Special resolution is required to be passed under section 14 of the Companies Act, 2013. Accordingly, as per section 117(3)(a), a copy of special resolution is required to be filed with concerned ROC through filing of E-form MGT-14 within 30 days of passing special resolution in the general meeting. Following documents are required to be attached with e-form MGT-14:
   a. Notice of general meeting along with copy of explanatory statement under section 102;
   b. Certified true copy of special resolution;
   c. Altered memorandum of association;
   d. Altered articles of association;
   e. Certified true copy of board resolution may be attached as an optional attachment.
5) **Filing of e-form INC-6:** The application for the Conversion of Private Company into OPC should be filed to the RoC in Form INC-6 with the following attachments:
   - The total list of members and creditors.
   - The latest Audited Balance Sheet and the Profit and Loss Account.
   - The copy of No Objection Letter from shareholders and creditors.
   - An affidavit of the declaration of the Directors of Company that all the creditors and shareholders have given consent for the Conversion of Private Company into OPC.
6) **Issuance of New Certificate of Incorporation:** On approval of Form MGT-14 and Form INC-6, the Registrar will issue a fresh Certificate of Incorporation with the Changed name to the applicant company or the Conversion of Company into OPC.

**Points to ponder:**

- A minor shall not become a member or nominee of the One Person Company.
- The Shareholder should not be holding any other OPC, or he/she should not be a member of any other OPC.
- The Shareholder of the new OPC should be a resident person of India.
- The Shareholder of the new OPC should have Indian nationality.

## COMPANIES AUTHORISED TO REGISTER UNDER THE COMPANIES ACT, 2013

1) For the purposes of Part XXI Companies, the word "company" includes any partnership firm, limited liability partnership, cooperative society, society or any other business entity formed under any other law for the time being in force which applies for registration under this Part.

2) With the exceptions and subject to the provisions contained in this section, any company formed, whether before or after the commencement of this Act, in pursuance of any Act of Parliament other than this Act or of any other law for the time being in force or being otherwise duly constituted according to law, and consisting of two or more members, may at any time register under this Act as an unlimited company, or as a company limited by shares, or as a company limited by guarantee, in such manner as may be prescribed and the registration shall not be invalid by reason only that it has taken place with a view to the company's being wound up:

**Provided that—**

i. a company registered under the Indian Companies Act, 1882 or under the Indian Companies Act,1913 or the Companies Act, 1956, shall not register in pursuance of this section;

ii. a company having the liability of its members limited by any Act of parliament other than this Act or by any other law for the time being in force, shall not register in pursuance of this section as an unlimited company or as a company limited by guarantee;

iii. a company shall be registered in pursuance of this section as a company limited by shares only if it has a permanent paid-up or nominal share capital of fixed amount divided into shares, also of fixed amount, or held and transferable as stock, or divided and held partly in the one way and partly in the other, and formed on the principle of having for its members the holders of those shares or that stock, and no other persons;

iv. a company shall not register in pursuance of this section without the assent of a majority of such of its members as are present in person, or where proxies are allowed, by proxy, at a general meeting summoned for the purpose;

v. where a company not having the liability of its members limited by any Act of Parliament or any other law for the time being in force is about to register as a limited company, the majority required to assent as aforesaid shall consist of not less than three-fourths of the members present in person, or where proxies are allowed, by proxy, at the meeting;

vi. where a company is about to register as a company limited by guarantee, the assent to its being so registered shall be accompanied by a resolution declaring that each member undertakes to contribute to the assets of the company, in the event of its being wound up while he is a member, or within one year after he ceases to be a member, for payment of the debts and liabilities of the company or of such debts and liabilities as may have been contracted before he ceases to be a member, and of the costs, charges and expenses of winding up, and for the adjustment of the rights of the contributories among themselves, such amount as may be required, not exceeding a specified amount;

vii. a company with less than seven members shall register as a private company.

3) In computing any majority required for the purposes of sub-section (1), when a poll is demanded, regard shall be had to the number of votes to which each member is entitled according to the regulations of the company.

Once the compliance with respect to requirements of chapter XXI of the Act is done with respect to registration and on payment of prescribed fees under section 403 of the Act, he Registrar shall certify that the company applying for registration is incorporated as a company under this Act, and in the case of a limited company that it is limited.

As per section 368 of the Act, all the properties whether movable and immovable (including actionable claims), belonging to or vested in a company at the date of its registration in pursuance of this Part, shall, on such registration, pass to and vest in the company as incorporated under this Act. However the registration under this part shall not affect its rights or liabilities in respect of any debts or obligations incurred or any contract entered by or behalf of the company before registration.

With respect to the suits and other legal proceedings taken by or against the company, or any public officer or member thereof, which are pending at the time of the registration of a company in pursuance of this Part, may be continued in the same manner as if the registration had not taken place.

The provisions of this Act with respect to staying and restraining suits and other legal proceedings against a company at any time after the presentation of a petition for winding up and before the making of a winding up order, shall, in the case of a company registered in pursuance of this Part, where the application to stay or restrain is by a creditor, extend to suits and other legal proceedings against any contributory of the company.

**Effect of Registration under Part XXI of the Act**

Following are the effects of registration of companies under this Part of the Act:

1. All provisions contained in any Act of Parliament or any other law for the time being in force constituting or regulating the company, including, in the case of a company registered as a company limited by guarantee, the resolution declaring the amount of the guarantee, shall be deemed to be conditions and regulations of the company, in the same manner as would, if the company had been formed under this Act, have been required to be inserted in the memorandum, were contained in a registered memorandum, and articles of Association.
2. All the provisions of this Act shall apply to the company and the members, contributories and creditors thereof, in the same manner as if it had been formed under this Act, subject to following: —
   (a) Table F in Schedule I shall not apply unless it is adopted by special resolution;
   (b) the provisions of this Act relating to the numbering of shares shall not apply to any company whose shares are not numbered;
   (c) in the event of the company being wound up, every person shall be a contributory, in respect of the debts and liabilities of the company contracted before registration, who is liable to pay or contribute to the payment of any debt or liability of the company contracted before registration;

(d) in the event of the company being wound up, every contributory shall be liable to contribute to the assets of the company, in the course of the winding up, all sums due from him in respect of any such liability as aforesaid and in the event of the death or insolvency of any contributory, the provisions of this Act with respect to the legal representatives of deceased contributories, or with respect to the assignees of insolvent contributories shall apply.

**3.** The provisions of this Act with respect to the registration of an unlimited company as a limited company; the powers of an unlimited company on registration as a limited company, to increase the nominal amount of its share capital and to provide that a portion of its share capital shall not be capable of being called-up except in the event of winding up and the power of a limited company to determine that a portion of its share capital shall not be capable of being called-up except in the event of winding up shall apply to these companies notwithstanding anything in any Act of Parliament or any other law for the time being in force.

**Essential pre-conditions of companies for Registration under Part XXI of the Act**

a) All the secured creditors of the company must either consented to or have given their no objection to company's registration under this Part;

b) Publish an advertisement in newspaper (one English and one in vernacular language) giving notice about registration under this Part, seeking objections and address them suitably;

c) file duly notarized affidavit from all the members or partners to provide that in the event of registration under this Part, necessary documents or papers shall be submitted to the registering or other authority with which the company was earlier registered, for its dissolution as partnership firm, limited liability partnership, cooperative society, society or any other business entity, as the case may be.

# Chapter 7 : Non-Corporate Entities

## INTRODUCTION

One of the first decisions that is faced by an entrepreneur is how the business should be structured. All businesses must adopt some legal configuration that defines the rights and liabilities of participants in the business's ownership, control, personal liability, life span, and financial structure. This decision will have longterm implications, so he has to select the form of ownership that is right for him. In making a choice, he will want to take into account the following:

- His vision regarding the size and nature of the business.
- The level of control he wishes to have.
- The level of "structure" he is willing to deal with.
- The business's vulnerability to litigation.
- Tax implications of the different organizational structures.
- Expected profit (or loss) of the business.
- Whether or not he will need to re-invest earnings into the business.
- His need for access to cash out of the business for himself.

## PARTNERSHIP

Partnership is an association of persons who agree to combine their financial resources and managerial abilities to run a business and share profits in an agreed ratio. Since the resources of a sole proprietor to finance, and his capacity to manage a growing business are limited, he feels the need for a partnership firm. Partnership business, therefore, usually grows out of the need for expansion of business with more capital, better supervision and control, division of work and spreading of risks.

Partnership firms are created by drafting a partnership deed among the partners. The partnership deed is registered to make a firm. Partnership firms in India are, governed by the Indian Partnership Act, 1932. Maximum no. of partners in a partnership firm can be 50 partners, and the Profit & loss are shared in manner as agreed in the partnership deed.

The Indian Partnership Act defines partnership as "Partnership" is the relation between persons who have agreed to share the profits of a business carried on by all or any one of them acting for all. The persons who have agreed to join in partnership are individually called "Partners" and collectively a 'firm'. A partnership firm can be formed with a minimum of two partners and it can have a maximum of fifty partners.

### Certain key definitions contained in the Indian Partnership Act, 1932:

As per Section 2(a) of Indian Partnership Act, 1932 an "act of a firm" means any act or omission by all the partners, or by any partner or agent of the firm which gives rise to a right enforceable by or against the firm.

As per Section 4 of Indian Partnership Act, 1932 "Partnership" is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all. Persons who have entered into partnership with one another are called individually, "partners" and collectively "a firm", and the name under which their business is carried on is called the "firm-name".

As per Section 7 of Indian Partnership Act, 1932 where no provision is made by contract between the partners for the duration of their partnership, or for the determination of their partnership, the partnership is partnership at will.

As per Section 8, particular partnership means a person may become a partner with another person in particular adventures or Undertakings.

**Holding out [Section 28]**

1. Anyone who by words spoken or written or by conduct represents himself or knowingly permits himself to be represented, to be a partner in a firm, is liable as a partner in that firm to anyone who has on the faith of any such representation given credit to the firm, whether the person representing himself or represented to be a partner does or does not know that the representation has reached the person so giving credit.
2. Where after a partner's death, the business is continued in the old firm name, the continued use of that name or of the deceased partners name as a part thereof shall not of itself make his legal representative or his estate liable for any act of the firm done after his death.

**Dissolution of a firm [Section 39]**

The dissolution of partnership between all the partners of a firm is called the dissolution of the firm.

**Insolvency and Bankruptcy of Partnership Firm**

The Insolvency and Bankruptcy of partnership firms where the amount of default is not less than one thousand rupees shall be governed by Insolvency and Bankruptcy Code, 2016.

## Is Partnership Firm a Body Corporate under Companies Act, 2013?

The definition of Body Corporate under Section 2 (11) of the Companies Act, 2013 specifically says that it does not include a co-operative society registered under any law relating to co-operative societies and any other body corporate (not being a company defined in the Act), which the Central Government may by notification specify in this behalf.

For an entity to be Legal/ Juristic person, it shall be recognized by law as a separate entity, have perpetual succession, must be competent to enter into a contract, capable to sue or being sued in its own name and can hold the property in its own name. A Partnership Firm does not possess all the attributes as:

- it is merely an association of individuals and the law does not recognize partnership to have a personality or existence distinct from its partners.
- it does not have a perpetual succession as the firm collapses on change in the partners of the firm which can be due to death or retirement of the partners.

- since it is not regarded as a legal entity, therefore the firm cannot enter into any contract on its own. Any Partner authorized by all the partners or all the Partners of the firm shall execute the contract.
- it can sue or be sued only if the Firm is a registered Partnership.

And hence, the concept of Limited Liability Partnership (LLP) which includes the benefits of both partnership and body corporate was introduced. LLP is formed and incorporated under the Companies Act with perpetual succession. It is a separate legal entity with no effect of change in partners on existence, rights or liabilities of the LLP. The definition of 'body corporate' under the Limited Liability Partnership Act, 2008 ('LLP Act') specifically includes LLP registered under the LLP Act.

## Features of Partnership

The features of partnership are as follows:

1. **Existence of an agreement:** Partnership is formed on the basis of an agreement between two or more persons to carry on business. It does not arise out of the operation of law as in the case of joint Hindu family business. The terms and conditions of partnership are laid down in a document known as Partnership Deed.
2. **Engagement in business:** A partnership can be formed only on the basis of a business activity. Its business may include any trade, industry or profession. Thus, a partnership can engage in any occupation - production and/or distribution of goods and services with a view to earning profits.
3. **Sharing of profits and losses:** In a partnership firm, partners are entitled to share in the profits and are also to bear the losses, if any.
4. **Agency relationship:** The partnership business may be carried on by all or any of the partners acting for all. Thus, each partner is a principal and so can act in his own right. At the same time, he can act on behalf of other partners as their agent. Thus, every partner can bind the firm by his acts.
5. **Unlimited Liability:** The liability of partners is unlimited as in the case of sole proprietorship. In case some obligation arises then not only the partnership assets but also the private property of the partners can be taken for the payment of liabilities of the firm.
6. **Common Management:** Every partner has a right to take part in the running of the business. It is not necessary for all partners to participate in the day-to-day activities of the business but they are entitled to participate. Even if partnership business is run by some partners, the consent of all other partners is necessary for taking important decisions.
7. **Restriction on transferability of share:** No partner can transfer his share in partnership to any other person. He may, however, do so with the consent of all other partners.
8. **Registration:** To form a partnership firm, it is not compulsory to register it. However, if the partners so decide, it may be registered with the Registrar of Firms.

9. **Duration:** The partnership firm continues at the pleasure of the partners. Legally a partnership comes to an end if any partner dies, retires or becomes insolvent. However, if the remaining partners agree to work together under the original firm's name, the firm will not be dissolved and will continue its business after settling the claim of the outgoing partner.

## Types of Partnership

According to the nature of agreement among partners, there can be three types of partnership as follows:

1. **Partnership at-will:** Such a partnership exists on the will of the partners. That is, it can be brought to an end whenever any partner gives notice of his intention to do so. (Section 7 of the Indian Partnership Act, 1932)
2. **Particular partnership:** A particular partnership is formed for undertaking a particular venture. It comes to an end automatically with completion of the venture. (Section 8 of the Indian Partnership Act, 1932)
3. **Partnership for a fixed duration:** Such partnership is for a fixed period of time say 2 years, 5 years or any other duration.

## Types of Partners

The various types of partner found in partnership firms are as follows:

1. **Active Partners:** Partners who take active part in the conduct of day-to-day business of the firm are called active partners. These partners carry on business on behalf of the other partners.
2. **Sleeping or dormant partners:** Sleeping or dormant partners are those who do not take active part in the management of the business. Such partners only contribute capital in the firm and are bound by the activities of other partners. However, they share in the profits and losses of the business.
3. **Others:** Active and sleeping partners are, as a matter of fact, the full-fledged partners i.e. they share in profits and losses of the business and are liable for its dues. However, there are other types of partners also who may be associated with partnership directly or indirectly. They are not full-fledged partners; such partners may include the following:

a. **Nominal Partners:** Nominal partners are those who do not have interest in the business but lend their name to the firm. They do not make any capital contribution, and are not entitled to take part in management, but are liable, like other partners, to third parties. Such partners generally have a pecuniary interest (like a share in the profits) in lending their name to a firm. However, in certain cases they may not have any pecuniary interest in doing so. For example, a reputed industrialist may, without any profit motive lend his name to a firm run by his family members.

b. **Partners by holding out:** If a person by his words or conduct holds out to another that he is a partner, he will be prevented from denying that he is not a partner. The person who thus becomes liable to third parties to pay the debts of the firm is known as a partner by holding out. (Section 28)

c. **Minor Partners:** A minor cannot be a partner according to Indian Contract Act. But he can be admitted to get the benefits if all the partners give their consent. He will share the profit equally but his liability will be limited in case of loss. (Section 30)

## Minor admitted into the benefits of partnership

A minor is a person who has not attained the age of 18 years. Since a minor is not capable of entering into a valid agreement, he cannot become partner of a firm. However, as mentioned earlier, he may be admitted to the benefits of an existing partnership as allowed under Section 30 of the Indian Partnership Act, 1932

**Merits of Partnership**

A partnership form of organization offers the following advantages:

1. **Ease in formation:** A partnership is very easy to form. All that is required is an agreement among the partners. Even the expenses to be incurred for registration are-not much.
2. **Pooling of financial resources:** A partnership commands more financial resources compared to sole proprietorship. This helps in expanding business and earning more profits. As and when a firm requires more money, more partners can be admitted.
3. **Pooling of managerial stalls:** A partnership facilitates pooling of managerial skills of all its partners. This leads to greater efficiency in business operations. For instance, in a big partnership firm, one partner can handle production function, another partner can look after all marketing activity, still another can attend to legal and personnel problems, and so on.
4. **Balanced business decisions:** In a partnership firm, decisions are taken unanimously after considering all the major aspects of a problem. This ensures not only balanced business decisions but also removes difficulties in the smooth implementation of those decisions.
5. **Sharing of risks:** Unlike sole proprietary organization, the risks of partnership business are shared by partners on a predetermined basis. This encourages partners to undertake risky but profitable business activities.
6. **Privacy:** It is not required for a partnership firm to publish its accounts. As a result, the affairs taking place in the business remain within the business. Also, the partners are the ones who carry out the significant decisions of the business, and hence there is no chance of leakage of trade secrets, and the privacy of the firm is maintained.
7. **Division of work:** In a partnership, all the firm's work is divided among the partners based on their knowledge and skills. Division of labor is possible in partnership. This division of work leads to efficient management, which results in higher profits.

## Limitations of Partnership

A partnership form of organisation suffers from the following major limitations:

1. **Uncertainty of existence:** The existence of a partnership firm is very uncertain. The retirement, death, bankruptcy or lunacy of any partner can put an end to the partnership. Further, the partnership business can come to a close if any partner demands it.

2. **Unlimited Liability:** It is true that like the sole proprietor each partner has unlimited liability. But his liability may arise not only from his own acts but also from the acts and mistakes of co-partners over whom he has no control. This discourages many persons with money and ability, to join a partnership firm as partner.
3. **Risks of disharmony:** In partnership, since decisions are taken unanimously, it is essential that all partners reconcile their views for the common good of the organisation. But there may arise situations when some partners may adopt rigid attitudes and make it impossible to arrive at a commonly agreed decision. Lack of harmony may paralyse the business and cause conflict and mutual bickering.
4. **Difficulty in withdrawal or Blocking of Capital:** Investment in a partnership can be easily made but cannot be easily withdrawn. This is so because the withdrawal of a partner's share requires the consent of all other partners. If a partner wishes to withdraw their wealth from the firm, they cannot do so alone. Withdrawal is possible only if the other partners agree to it. The partners are also not allowed to transfer their shares to someone else. If someone wants to do so, then they must get the consent of the other partners. As a result, they lose the liquidity of their investment. This is one of the significant reasons that discourage people from investing in a partnership.
5. **Lack of institutional confidence:** A partnership business does not enjoy much confidence of banks and financial institutions. It is because the nature of its activities is not disclosed at public and the agreement among partners is not regulated by any law. As a result, large financial resources cannot be raised by partnership and growth of business cannot be ensured.
6. **Lack of Public Trust:** The public has less confidence in partnership firms since their annual reports and accounts are not published. Therefore, the public does not trust their dealings.
7. **Lack of a Control:** Leadership can both uplift and derail a firm. Combined ownership takes away the possibility of leadership and lack of leadership leads to directionless operations. On the other hand, in a partnership firm, certain partners can be given the position of designated partner with more powers and responsibilities.
8. **Difficulties of expansion:** It is difficult for a partnership firm to undertake modernization of expansion of its operations. This is because of its inability to raise adequate funds for the purpose. Limited membership (restricted to 50 as per the Companies Act, 2013) and their limited personal resources do not permit large amounts of capital to be raised by the partners. Therefore, large-scale business cannot generally be organized by partnerships.

It is quite obvious from the discussions that the partnership form of organisation is excellent when the size of business is medium, i.e. neither too small not too large, and when the partners can work in full co-operation with one another.

## Partnership Deed

Partnership deed, also known as a partnership agreement, is a document that outlines in detail the rights and responsibilities of all parties to a business operation. It has the force of law and is designed to guide the partners in the conduct of the business. It is helpful in preventing disputes and disagreements over the role of each partner in the business and the benefits which are due to them.

The key ingredients of a Partnership Deed are given below:

1. **Definitions and vital information**

   The partnership deed normally carries the name of the business, the address of its principal place of business, name and address of all partners and a short summary of the nature of business the partners intend to operate.

2. **Partnership duration**

   The Deed must mention the firm's establishment date and the deal period.

3. **Investment**

   The deed gives important financial details of the partnership, such as the amount of capital to be invested by each partner, the Profit /Loss sharing of each partner, the salaries to be paid to each partner and the method of distributing the business income. The partnership deed also documents the accepted method of raising additional capital, if necessary how loan funds may be raised and rate of interest if any, applicable on the loans.

4. **Accounting**

   The partnership deed provides for the accepted method of accounting for the cash flow, profit and loss, and assets and liabilities of the business; it also defines the fiscal year to be used in accounting statements and how these statements will be distributed among the partners and other shareholders.

5. **Duties, powers and obligations of the partners**

   The duties, powers and obligations of each partner may also be spelt out in the Partnership Deed. The Deed may also provide designate a partner as the Managing Partner, who will be responsible for day to day management and conduct of the business.

6. **Profit & loss ratio**

   Profit/Loss ratio to be accrued to and be borne by the Partners.

7. **Withdrawals**

   The document must also provide for actions to be taken in case of the voluntary withdrawal or death of a partner. In such a case, accounts will have to be drawn up to ascertain the assets, liabilities and the entitlement of each partner (including the outgoing partner).

8. **Admission/ Retirement of a partner**

   Details/ Rules regarding the future admission, retirement and exit of a partner.

9. **Expulsion**

   If a partner is proving to be a hindrance or detriment to the business, or loses legal rights in a bankruptcy or other court action, the other partners must have a method of modifying the partnership rights of or expelling him.

10. **Banking and Partnership Funds**

    The funds held in the firm's name will be placed in a bank account designated by the Partners.

11. **Borrowings**

    A written consent of all the partners will be required for taking loans from banks, financial institutions, or any third parties for the firm's financial requirements.

12. **Dissolution**

    The partnership deed should also describe the methods by which the partnership and business will be dissolved, if desired, and how the accounts among the partners would be settled at the termination of the business.

13. **Arbitration**

    As in all business contracts, a partnership deed must provide for the means of arbitration of disputes. The main goal of the deed is to avoid expensive litigation over details that have not been fully worked out in the signed agreement.

    Partnership deed is a written agreement between the partners and is mandatorily registered in the court of law whereas partnership agreement is an agreement between the partners which may or may not be not registered in the court of law.

## Benefits of Partnership Deed

A partnership deed can be in an oral format; however, it is crucial to have it written. The drawback with the oral one is that it has no value for tax purposes, and one cannot use it as a legal document if there's any dispute among the partners. So, it is desirable to have a written partnership deed.

a. It enables business owners to file a suit in court in case of a dispute.
b. It helps avoid any misunderstanding or conflict among the business owners as all the terms and conditions have been decided and mentioned already in the Deed.
c. It clearly outlines the duties of each partner.
d. It provides details of the profit/loss ratio and reduces the chances of misunderstanding.
e. It mentions the amount invested by each partner in the business.
f. It also details the salary and commission paid to partners, and if any of the partners withdraw the capital, then what interest they will have to pay.

## Registration Procedure

A partnership firm can be registered whether at the time of its formation or even subsequently. One needs to file an application with the Registrar of Firms of the area where the business is located.

1. Application for partnership registration should include the following information, namely, name of your firm, name of the place where business is carried on, names of any other place where business is carried on, date of partners joining the firm, full name and permanent address of partners and duration of the firm. The Application should be duly signed by all the partners of the firm or by their duly authorised agents.
2. Every partner needs to verify and sign the application.
3. Ensure that the following documents and prescribed fees are enclosed with the registration application:
   - Application for Registration in the prescribed Form -1
   - Duly filled Affidavit
   - Certified copy of the Partnership deed (The deed so created by the partners should be on a stamp paper in accordance with the Indian Stamp Act/ stamp paper as applicable in the State where the Partnership Deed is executed)
   - Proof of ownership of the place of business or the rental/lease agreement thereof.

As per section 71 of Indian Partnership Act, states are authorized to make their own regulations with respect to prescribe the fee structure for registration or incorporation of partnership .It may be also be noted that the name of the partnership firm should not contain any words which may express or imply the approval or patronage of the government except where the government has given its written consent for the use of such words as part of the firm's name. Once the Registrar of Firms is satisfied that the application procedure has been duly complied with, he shall record an entry of the statement in the Register of Firms and issue a Certificate of Registration.

## Consequences of Non-Registration

It is not compulsory to register partnership firm as there are no penalties for non-registration. However, it is advisable since the following rights are denied to an unregistered firm:

- A partner cannot file a suit in any court against the firm or other partners for the enforcement of any right arising from a contract or right conferred by the Partnership Act.
- A right arising from a contract cannot be enforced in any Court by or on behalf of your firm against any third party.
- Further, the firm or any of its partners cannot claim a set off (i.e. mutual adjustment of debts owned by the disputant parties to one another) or other proceedings in a dispute with a third party.

## Registration under Income Tax

It should be noted that registration with the Registrar of Firms is different from registration with the Income Taxation Department. It is mandatory for all firms to apply for registration with the Income Tax Department and have a PAN Card. After obtaining a PAN Card, the partnership firm is required to open a Current Account in the name of the partnership firm and to operate all its operations through this bank account.

# HINDU UNDIVIDED FAMILY (HUF)

## Meaning of Joint Hindu Family Business

The Joint Hindu Family Business is a distinct form of organisation peculiar to India. Joint Hindu Family Firm is created by the operation of law. It does not have any separate and distinct legal entity from that of its members.

The laws that govern HUFs are not codified and are read along with the Hindu Succession Act and the Incometax Act.

The business of Joint Hindu Family is controlled under the Hindu Law instead of Partnership Act. The membership in this form of business organisation can be acquired only by birth or by marriage to a male person who is already a member of Joint Hindu Family.

"When two or more families agree to live and work together, throw their resources and labour with joint stock and share profits and the losses together, then this family is known as composite family."

There are two schools of Hindu Law-one is Dayabhaga which is prevalent in Bengal and Assam and the other is Mitakshara prevalent in the rest of the-country. According to Mitakshara law, there is a son's right by birth in the property of joint family. It means, when a son is born in family, he acquires an interest in the property jointly held by the family.

The business of the Joint Hindu Family is controlled and managed by one person who is called 'Karta' or 'Manager'. The Karta or manager works in consultation with other members of the family but ultimately he has a final say. The liability of Karta is unlimited while the liability of other members is limited to their shares in the business.

## Characteristics of a Joint Hindu Family Business

1. **Governed by Hindu Law:**

   The business of the Joint Hindu Family is controlled and managed under the Hindu law. There are two schools of Hindu law:

   (i) **Dayabhaga:** It prevails in West Bengal & Assam and allows both the male & female members to be co-parceners.

   (ii) **Mitakshara:** There are four schools of Mitakshara. The application of schools of Mitakshara is regionwise. It allows only male members to be co-parceners.

2. **Management:**

   All the affairs of a Joint Hindu Family are controlled and managed by one person who is known as 'Karta' or 'Manager'. The Karta is the senior most male member of the family. He works in consultation with other members of the family but ultimately he has a final say. The members of the family have full faith and confidence in Karta. Only Karta is entitled to deal with outsiders. But other members can deal with outsiders only with the permission of Karta.

3. **Membership by Birth:**

   The membership of the family can be acquired only by birth. As soon as a male child is born in family, he becomes a member. Membership requires no consent or agreement.

4. **Liability:**

   Except the Karta, the liability of all other members is limited to their shares in the business. The Karta is not only liable to the extent of his share in the business but his separate property is equally attachable and amount of debt can be recovered from his separate property.

5. **Permanent Existence:**

   The death, lunacy or insolvency of any member of the family does not affect the existence of the business of Joint Hindu Family. The family goes on doing its business.

6. **Implied Authority of Karta:**

   In a joint family firm, only Karta has the implied authority to contract debts and pledge the credit and property of the firm for the ordinary purpose of the businesses of the firm.

7. **Minor also a Partner**:

   In a partnership, minor cannot become co-partner though he may be admitted to the benefit of partnership. In a Joint Hindu Family firm minor is a partner.

8. **Dissolution:**

   The Joint Hindu Family Business can be dissolved only at the will of all the members of the family. Any single member has no right to get the business dissolved.

## Benefits of HUF

1. **Easy to Start:**

   It is very easy to start the Joint Hindu Family Business. No legal formalities are required to be faced, such as registration. It requires no agreement, though in actual practice, it is documented to avoid litigation and for regulatory purposes.

2. **Efficient Management & Control:**

   The management of Joint Hindu Family Business is centralised in the hands of Karta of family. In this business, Karta takes all decisions and gets them implemented with the help of other member. No other member interferes in his management.

3. **Secrecy:**

   In Joint Hindu Family Business, all the decisions are taken by the 'Karta' himself. He is in a position to keep all the affairs to himself and maintains perfect secrecy in all matters.

4. **Prompt Decision:**

   The Karta is the only person who exercises control and direction over the business. He may not consult anyone in taking decisions. This ensures prompt or quick decisions. Being the sole master, he takes prompt decisions and makes advantage of the opportunity.

5. **Economy:**

   For the success of any business, economy is a must. It is well- balanced and maintained in Joint Hindu Family Business. The Karta of family spends money with great caution and economy.

6. **Credit Facilities:**

   In Joint Hindu Family Business, the credit facilities are more. One reason for this is that liability of the 'Karta' is unlimited. Karta is having personal relations with others, which are also helpful in raising credit.

7. **Expanded loyalty & cooperation:**

   In Joint Hindu Family Business, it is the natural love and affection which the members are having for each other. It helps to run the business more efficiently and smoothly.

8. **Freedom regarding Selection of Business:**

   The Karta is at freedom to select any business of his choice. He has not to depend on others.

## Limitations of HUF

1. **Limited Resources:**

   The Joint Hindu Family Business experiences a financial shortage, since it is mostly dependent on ancestral property. This limits the possibility of business expansion. As a result, the size of the business remains small, and the Karta cannot benefit from large-scale economies.

2. **Unlimited Liability of Karta:**

   The Karta carries not just the burden of decision-making and management, but also unlimited liability. His personal belongings might be utilized to pay off business debts.

3. **Dominance of Karta:**

   The control and management of the business are vested solely in the hands of the Karta, which may not always be acceptable to the other members, and it may lead to conflicts and breakdown of the family unit.

4. **Limited Managerial Skills:**

   Karta cannot be an expert in all areas of management, his poor judgments may affect the business. His failure to make good decisions may even lead to financial difficulties and losses. Also, Hindu Undivided Family do not have adequate funds to hire experts or professionals in several domains such as purchasing, manufacturing, marketing, etc.

5. **Misuse of Power:**

   Management of a Joint Hindu Family Business is centered in the hands of the family's Karta. No other member is allowed to interfere with his management. This may lead to power misuse, with Karta misusing his position for personal benefits.

6. **Limited Membership:**

   The membership of the business is restricted to family members exclusively. No one from outside the Joint Hindu Family Business can join the business. Therefore, they face the demerit of limited membership.

## Hindu Undivided Family (HUF) - Formation

**Create a HUF Deed.**

One has to prepare a deed on stamp paper declaring the formation of the HUF. It should have all the details, including the name of karta, co-parceners, address and source of funds in the corpus. Creating a HUF Deed is not mandatory. However, it is always beneficial to have a HUF Deed. Key issues to be noted in preparation of a HUF Deed are:

(a) A HUF deed is a written formal document on a stamp paper (as applicable in the respective State) specifying the name of Karta and Coparceners of HUF.

(b) The eldest male member of HUF becomes Karta of HUF.

(c) The name of members of HUF and the name of the HUF is also required to be stated in the HUF Deed at the time of creating of HUF.

(d) The name of HUF is usually the name of the Karta followed by the word HUF e.g. Ram Kumar HUF.

(e) HUF Deed also states the capital with which the HUF has been initiated. There are various sources through which capital can be introduced.

(f) A declaration is also provided by each member of family where they declare the name of Karta and also state that –

   i. Karta has the authority of the accounts vested in his hand.

   ii. Karta holds the right to govern all the transactions of the HUF accounts on behalf of the members.

(g) Further, a rubber stamp of HUF will also be prepared. Rubber stamp should be Rectangular. Rubber Stamp will be affixed on all the documents pertaining of HUF to authorize the transaction.

(h) It is recommended that the Deed should be notarised.

   i. Register the Deed.

   ii. Obtain PAN.

   iii. Once the declaration deed is made, the karta should apply for a permanent account number (PAN) for the HUF. This is mandatory because all financial transactions must carry PAN.

   iv. Open bank account.

After one has allotted a PAN, open a bank account in the name of the HUF. It is also advisable to get some stationery printed for official communication. The HUF is now functional. The karta will have to invest in tax saving instruments and file tax returns on behalf of the HUF.

While there are tax advantages of forming an HUF, the following matters merit consideration:

- One person cannot form HUF. An HUF is formed by a family.
- An HUF is automatically created at the time of marriage.

- HUF consists of a common ancestor and all of his lineal descendants, including their wives and unmarried daughters. after 1-9-2005, daughter married or unmarried, is a coparcener like a son.
- Hindus, Buddhists, Jains and Sikhs can form HUFs.
- HUF usually has assets which come as a gift, a will, or ancestral property, or property acquired from the sale of joint family property or property contributed to the common pool by members of HUF.
- Once an HUF is formed it must be formally registered in its name. An HUF should have a legal deed. The deed shall contain details of HUF members and the business of the HUF. A PAN number and a bank account should be opened in the name of the HUF.
- Use a capital asset to establish the corpus of the HUF. This can be ancestral property, assets gifted by relatives and friends, or received by the HUF through a will. If you give a personal asset to the HUF, the income will be clubbed with your own. Gifts of over 50,000 a year received by HUF will be taxable. The best way is for the HUF to receive assets as part of a will.

## Key Points in creation of HUF and format of Deed for creation of HUF

- Under the Income Tax Act, an HUF is a separate entity for the purpose of income tax return.
- The same tax slabs are applicable to HUF as to individual assessee.
- One cannot transfer your own assets/money into HUF.
- If one has ancestral property and earning some income from this property, then it is better to transfer this asset to HUF and save tax up to exemption limit applicable to individual.
- One can transfer the money received on sale of ancestral property /assets into your HUF.
- The income from property of HUF can be further invested in instruments such as shares, mutual funds, etc. and will be assessed under HUF.
- Existence of property or multiple members is not a pre-requisite to create HUF. A family which does not own any property may still have the character of Hindu joint family. This jointness is understood in terms of faith and food. This is because a Hindu is born as a member of the joint family.
- Any gifts received by the members of HUF (birthday, marriage, etc.) can be treated as assets of HUF.
- The HUF is taxable as separate person under income tax hence one can save tax from basic exemption of Rs. 2.5 lakh. HUF will also gain from the tax slab structure of computing income tax.
- Apart from basic exemption of Rs. 2.50 lakh, section 80C deduction up to Rs. 1.50 lakh is also available.

## SOLE PROPRIETORSHIP

The vast majority of small businesses start out as sole proprietorships. The sole proprietorship is a form of business that is owned, managed and controlled by an individual. He has day-to-day responsibility for running the business. He has to arrange capital for the business and he alone is responsible for its management. He is therefore, entitled to the profits and has to bear the loss of business. Sole proprietorships own all the assets of the business. He also assumes complete responsibility for any of its liabilities or debts. In the eyes of the law and the public, the sole proprietor and the business are one and the same.

It is the simplest and most easily formed business organization. This is because not much legal formality is required to establish it. For instance, to start a factory, the permission of the local authorities is sufficient. Similarly, to start a restaurant, it is only necessary to get the permission of local health authorities. Or again, to run a grocery store, the proprietor has only to follow the rules laid down by local administration.

### Merits of Sole Proprietorship

A sole proprietary organization has the following advantages:

- **Easy formation:** A sole proprietorship business is easy to form where no legal formality involved in setting up this type of organization. It is not governed by any specific law. It is simply required that the business activity should be lawful and should comply with the rules and regulations laid down by local authorities.
- **Swift Decisions:** In sole proprietary organization, all the decisions relating to business operations are taken by one person, which makes functioning of business simple and easy. The sole proprietor can also bring about changes in the size and nature of activity. This gives better control to business.
- **Sole beneficiary of profits:** The sole proprietor is the only person to whom the profits belong. There is a direct relation between effort and reward. This motivates him to work hard and bear the risks of business.
- **Benefits of small-scale operations:** The sole proprietorship is generally organized for small-scale business. This helps the proprietor's family members to be employed in business. At the same time such a business is also entitled to certain concessions from the government. For example, small industrial organisations can get electricity and water supply at concessional rates on a priority basis.
- **Inexpensive Management:** The sole proprietor does not appoint any specialists for various functions. He personally supervises various activities and can avoid wastage in the business.
- **Confidentiality:** A sole proprietor can keep all business-related information to themselves as the business's only decision-maker. The law does not bind them to make the accounts of a sole proprietorship public.
- **Lesser paperwork:** Business setup involves several tasks. Among these, one of the most dreaded ones is paperwork or documentation. Most of the 'would-be' business owners do not wish to spend their time in the lengthy process of registering the business as a corporation. So, for such individuals, a sole proprietorship is the best option. The

paperwork in a sole proprietorship is much less. Hence, business owners can spend their time planning the business strategies to prevent risks in the long-term journey.

- **Simple tax calculations:** One of the benefits of being a sole proprietor is that the taxes are simpler. The tax requirements are pretty straightforward compared to the other business structures. Sole proprietorships are not considered separate legal entities. So, business income or losses are reported on the owner's income tax. The sole proprietors need not file taxes separately for personal and business transactions. Besides these, sole proprietors also get certain tax advantages accompanying small business deductions.
- **Lower business fees:** Starting a new venture with a tight budget is not uncommon. Several individuals plan their ventures with less capital. For such entrepreneurs, the sole proprietorship is the best business structure. Sole proprietorships can help the owners save on registration. Also, the legal requirements and involved costs in a sole proprietorship are much less. A sole proprietorship is, therefore, very affordable. If the venture is well-planned from the start, with 100 percent commitment, one can easily set up a sole proprietorship business.

## Limitations of Sole Proprietorship

A sole proprietor generally suffers from the following limitations:

1. **Limitation of management skills:** A sole proprietor may not be able to manage the business efficiently as he is not likely to have necessary skills regarding all aspects of the business. This poses difficulties in the growth of business also.
2. **Limitation of Resources:** A significant disadvantage of owning a sole proprietorship is the challenge of raising capital. Though the setup costs are much lower in a sole proprietorship, it is difficult to finance the business because banks mostly prefer to finance established businesses. Also, since the revenue in such companies is more significant, they are considered to have a strong credit history. In a sole proprietorship, the business is wholly reliant on a single owner's finances, investments, and credit history. So, banks and other lenders are often doubtful about the repayment aspect.
3. **Unlimited liability:** The sole proprietor is personally liable for all business obligations. For payment of business debts, his personal property can also be used if the business assets are insufficient.
4. **Lack of continuity:** The owner and their business are a singular entity in a sole proprietorship. While this has several advantages, the continuity of this form of business depends solely on the owner's well-being. In case of death, insolvency, imprisonment, etc., it can shut down if there is no successor or heir to continue the business.
5. **Selling the business is a challenge:** Generally, entrepreneurs do not want to consider the possibility of selling their businesses. But as the owner, it is practical to contemplate passing the baton. Selling a sole proprietorship business is challenging. If the business is significantly profitable, selling it would trigger high capital gains tax. Also, selling off a sole proprietorship business means selling the debts as well. New start-ups might have more debts than profits. This often makes it difficult to predict profits for potential buyers.

6. **Risk in decision-making:** One of the significant disadvantages of a sole proprietorship that several people do not consider is the risk of making wrong decisions. As mentioned earlier, the final decision of every business function depends on the owner. In a sole proprietorship business, there is nobody to assist in decision-making. So, the risk of errors in decisions is high in sole proprietorships.
7. **No economies of scale:** Large-scale business organizations enjoy large-scale economies as well. That means they can produce more in lesser overhead costs per product.

But for sole proprietorships, this is hard to achieve. Hence, the cost of production of sole proprietorships is generally high. So, facing competition from larger organizations becomes quite challenging for sole proprietorship businesses.

From the above account of the merits and limitations, it becomes clear that it is only personal services like repair work, tailoring etc. small factories, retail shops and professional activities which can be set up as sole proprietary organizations. In India, this form of organization is quite popular and accounts for the largest number of business units.

## Procedure for Formation of Sole Proprietorship Firm

Sole Proprietor is formed, managed and controlled by one individual. No deed or agreement is required to constitute a Sole Proprietorship.

However, in actual practice and keeping in mind the nature of business activity, registration may be required under the following enactments as prevailing in the respective States or of the Central Government, such as

i. Shops and Commercial Establishments Act (State specific)
ii. Law relating to Professional Tax (State specific)
iii. Registration under Micro, Small and Medium Enterprises Development Act, 2006.
iv. Registration as a Small Scale Industry (State specific)
v. GST registration (with the launch of GST, only GSTIN will be used for Import-Export Code Number)
vi. Intellectual Property laws.

## MULTI STATE CO-OPERATIVE SOCIETY

The Multi-State Cooperative Societies (MSCS) Act, enacted in 1984, was modified in 2002, in keeping with the spirit of the Model Cooperatives Act. Unlike the State Laws, which remained as a parallel legislation to co-exist with the earlier laws, the MSCS Act, 2002 replaced the earlier Act of 1984. The Act and the Rules thereunder facilitates the incorporation of cooperative societies whose objects and functions spread over to several states.

The Act provides for formation of both primary (with both individual and institutional members) and federal cooperatives (with only institutional membership).

Their main objects shall be serving the interests of members in more than one state and their by-laws shall provide for social and economic betterment of their members through self-help and mutual aid in accordance with co- operative principles (Sec. 7). Otherwise, they are ineligible for registration. Under Section 9 of the said Act, a multi- state co-operative society is a body corporate with limited liability.

In order to ensure financial discipline, extensive provisions have been enacted. No part of the fund other than net profit shall be distributed among members (Sec.62). Investment of society's fund only in recognized securities is permissible (Sec.64). Contribution to political parties or loans to non-members or borrowing from external sources are prohibited. Annual auditing by recognized auditors is mandatory (Sec.70).

Central Government may direct for special audit if it is of the opinion that the society's affairs are not being managed in accordance with the co-operative principles or prudent commercial practices (Sec.77).

Any application for the registration of a multi-state cooperative society, of which all the members are individuals, should be signed by at least fifty persons from each of the states concerned. In the case of a society of which the members are cooperative societies, it should be signed by duly authorized representations of at least five such societies registered in different states.

## Benefits of Multi State Co-Operative Society

1. MSCS provides loans at reasonable rates of interest to the poor. This benefits them, as they do not have to go to financiers who lend at high interest rates.
2. MSCS can function pan India as they can start branches in different districts and states.
3. As regulatory requirements of filing, etc, is minimum, MSCS have low compliance costs.
4. A Multi State Co-operative Credit Society belongs to its members, who are at the same time the owners and the customers of their Society. This creates a sense of belonging and ownership among the members.

## Formation of Multi State Co-Operative Society

A. **An application in Form -1 (under sub-rule(1) of rule 3 of the Multi State Cooperative Societies Rules, 2002) should be filed with the Central Registrar of Cooperative Societies, New Delhi along with the following enclosures:**

   1. A certificate from the bank stating credit balance there in favour of the proposed multi-state co-operative society.
   2. A scheme explaining how the proposed multi state co-operative society has reasonable prospects of becoming a viable unit.
   3. Four copies of bye-laws in original.
   4. Proposed area of operation for registration shall initially be permitted for two contagious states only.

5. List of at least 50 members from each state. The list has to be submitted in the format annexed with the Multi State Cooperative Societies Act, 2002 (MSCS Act, 2002) along with the copies of ID proofs of the members duly attested by Chief promoter.
6. Certified copies of the resolutions passed by the proposed society along with the certified copy of the resolution of the promoters which shall specify the name and address of one of the applicant(s) to whom the Central Registrar may address correspondence under the rules before registration and dispatch or hand over registration documents.
7. Contact number and e-mail address of the Chief Promoter or Society on cover page.

**B. For societies having objects related to thrift and credit and for multi-purpose societies following additional documents are required to be submitted along with documents mentioned at point [A] above:**

1. No Objection Certificate from the Registrar of Cooperative Societies of the States/U.T. where the area of operation of the society is proposed to be confined.
2. A certificate to the effect that the credentials of the Chief Promoter/Promoters have been verified by the Registrar of Co-operative Societies of the state where the head office is proposed to be located.

All documents to be submitted in original with the signatures of the Chief Promoter/Promoters on each page.

**Note:** Societies which are already registered under the MSCS Act, 2002 and are desirous of expanding their area of operations falling under category (B) above shall be required to submit an No Objection Certificate as mentioned at [B](1)

## Registration Procedure

1. For the purposes of registration of a multi-state cooperative society under this Act, an application shall be made to the Central Registrar in such form and with such particulars as may be prescribed.
2. The application shall be signed:
   a. in the case of a multi-state cooperative society of which all the members are individuals - by at least fifty persons from each of the state concerned;
   b. b. in the case of a multi-state cooperative society of which the members are cooperative societies - by duly authorised representatives on behalf of at least five such societies as are not registered in the same state; and
   c. in the case of a multi-state cooperative society of which another multi-state cooperative society and other cooperative societies are members, by duly authorised representatives of each of such societies: Provided that not less than two of the cooperative societies referred to in this clause, shall be such as are not registered in the same state;

d. in the case of a multi-state cooperative society of which the members are cooperative societies or multi-state cooperative societies and individuals, by at least

   i. fifty persons, being individuals, from each of the two states or more; and

   ii. one cooperative society each from two states or more or one multi-state cooperative society.

3. The application shall be accompanied by four copies of the proposed bye-laws of the multi-state cooperative society and the persons by whom or on whose behalf such application is made shall furnish such information in regard to the society as the Central Registrar may require.

4. If the Central Registrar is satisfied

   a. that the application complies with the provisions of this Act and the rules;

   b. that the proposed multi-state cooperative society satisfies the basic criterion that its objects are to serve the interests of members in more than one state;

   c. that its bye-laws provide for social and economic betterment of its members through self-help and mutual aid in accordance with the cooperative principles;

   d. that the proposed bye-laws are not contrary to the provision of this Act and the rules, he may register the multi-state cooperative society and its bye-laws.

5. The application for registration shall be disposed of by the Central Registrar within a period of four months from the date of receipt thereof by him.

6. Where the Central Registrar refuses to register a multi-state cooperative society, he shall communicate, within a period of four months from the date of receipt of the application for registration, the order of refusal together with the reasons thereof to the applicant or applicants, as the case may be. Provided that no order or refusal shall be made unless the applicants have been given a reasonable opportunity of being heard.

The application for registration of the Multi- State Cooperative Society shall be disposed of by the Central Registrar within a period of four months from the date of receipt thereof by him and if the application for registration is not disposed of within a period of four months specified above or the Central Registrar fails to communicate the order of refusal within that period, the application shall be deemed to have been accepted for registration and the Central Registrar shall issue the registration certificate in accordance with the provisions of the MSCS Act, 2002 and the rules made thereunder.

## Registration certificate

Where a multi-state cooperative society is registered under this Act, the Central Registrar shall issue a certificate of registration signed by him, which shall be conclusive evidence that the society therein mentioned is duly registered under this Act, unless it is proved that the registration of the society has been cancelled.

# TRUST

A Trust is a relationship in which a person or entity holds a valid legal title to a certain property which is known as the Trust property. The Trust is bound by a fiduciary duty to exercise that legal title for the benefit of any one or more individuals or group of individuals or organisations, who are known as the Beneficiaries. The Trust shall be governed by the terms of the Written Trust agreement.

Trust is defined in section 3 of the Indian Trust Act, 1882 as "an obligation annexed to the ownership of property and arising out of a confidence reposed in and accepted by the owner, or declared and accepted by him, for the benefit of another or of another and the owner. In other words, it is simply a transfer of property by one person (the settlor) to another (the "trustee") who manages that property for the benefit of someone else (the "beneficiary"). The settlor must legally transfer ownership of the assets to the trustee of the trust.

The statutory basis governing Trusts, in general, under Indian law is the Indian Trusts Act, 1882. Generally, there are two types of trusts in India: private trusts and public trusts. Private trusts are regulated by the Indian Trusts Act, 1882, whereas Public trusts are classified as Charitable and religious trusts. The Charitable and Religious Trust Act, 1920, the Religious Endowments Act, 1863, the Charitable Endowments Act, 1890, the Societies Registration Act, 1860, and the Bombay Public Trust Act, 1950 are the relevant legislations for the recognition and enforceability of public trusts. Moreover, in recent times, trusts can also be used as a vehicle for investments, such as mutual funds and venture capital funds. These trusts are governed by Securities and Exchange Board of India (SEBI).

In India, there are thousands of trusts created by the owner of industrial houses and rich individuals and their families. Under Indian laws, Public Charitable Trusts are treated as organisations with charitable purpose entitling all the tax benefits applicable. Examples of Public Charitable Trusts promoted by business families are Paragon Charitable Trust, Sir Dorabji Tata Trust, etc. Private trust or family trust is not a Public Charitable Trusts and hence does not enjoy the privileges entitled to a trust with charitable purpose.

## Objectives of a Trust

As per Section 4 of the Indian Trusts Act, 1882, a trust may be created for any lawful purpose. The purpose of trust is lawful unless it is:

- Forbidden by law, or
- is of such nature that, if permitted, it would defeat the provisions of any law, or
- is fraudulent, or
- involves or implies injury to the person or property of another, or
- the court regards it as immoral or opposed to public policy.

## Persons who can create a Trust

According to Section 7 of Indian Trusts Act, 1882, a trust may be created by the following persons:

- Every person competent to contract
- HUF

- AOP
- Trust by a woman
- Company

## Persons who can be a Trustee

As per Section 10 of the Indian Trust Act, 1882, any person who is capable of holding property may be a trustee; except to the condition of discretion of trust, in that case, he cannot execute it unless he is competent to contract.

## Difference between Public Trust and Private Trust

**a.** Identification of the beneficiaries of the Trust is a simple way to differentiate between a public and a private trust. If the beneficiaries make up a large or substantial body of public, then the trust in question is public. A public trust exists "for the purpose of its objects, the members of an uncertain and fluctuating body," and is managed by a board of trustee. If, however, the beneficiaries are a narrow and specific group such as the employees of a company, then the trust is private.

**b.** in a Public Trust, the interest is vested in an uncertain and fluctuating body . They are the general public or class thereof. In a Private Trust, beneficiaries are definite and ascertained individuals. (Supreme Court in Deoki Nandan v. Murlidhar 1957 AIR 133 1956 SCR 756)

**c.** Their domains are different; public trusts have larger and wider domain whereas private trusts have limited and narrow domain.

A trust for the benefit of employees of a company however numerous would not be considered as public charitable. For example, an industrialist who creates a trust for the benefit of his 5,000 people, their spouses and children is considered private because who the beneficiaries are known.

While a public trust is set up for what is called 'uncertain and fluctuating body of persons', it is possible to create a sectarian or communal trust as a public charitable trust. There are trusts which are only for specific religious communities. However, such trusts may not be tax-exempt.

# EXEMPTIONS AVAILABLE TO TRUSTS

Exemptions available to Trusts are primarily governed by the provisions of the Income Tax Act, 1961. The exemption has to be read keeping in mind whether the Trust is a Public Charitable Trust, Private Trust, Religious Trust, etc.

## Certain key exemptions are listed below:

### Tax exemption under Section 10 of the Income Tax Act, 1961

Total tax exemption is available for certain types of trusts which include those which are formed for any of the activities related to sports, education, scientific research, professions, or promotion of khadi and village-based industries, hospitals etc. and are notified as charitable or religious institutions.

**Tax exemption under Section 11 of Income Tax Act, 1961**

As per Section 11, any income, profits or gains obtained by a trust from a property held by the trust established wholly for the purposes of religious or charitable nature shall not be included in the total income of the trust. Since such income shall not constitute to be a part of the trust's income, therefore, it is not taxable. However, as per section 13, there are certain situations where the tax exemptions under section 11 are not applicable.

Such instances include where –

a) income earned from the property held under the trust of private religious nature and does not endure benefit for the public, or
b) the entire income of a charitable trust which is established for a particular religion, community or caste, income of those charitable trust whose funds do not get invested in the modes specified under section 11(5).

**Tax exemption under Section 12 of the Income Tax Act, 1961**

The incomes that are excluded from the computation of taxable income of trust or society are as follows:

1. Income which is derived from the property that is held under the authority of trust with the purposes which are wholly charitable or religious in nature.
2. In cases of charitable trusts, specifically those formed before 1st of April, 1961, income which is acquired from the property which is held partially for religious or charitable purposes within India.
3. In furtherance of the above case, the income which is set apart to a certain extent and which does not exceed 25% of the total income.
4. In cases of income that is obtained from a trust created before 1st April, 1952 for charitable purposes and spent outside India.
5. Income made by way of voluntary contributions towards the corpus of the trust.
6. Charitable trusts created for the benefit of any of the socially and economically backward castes such as Scheduled Castes, Scheduled Tribes or women or children.

Trusts are allowed to set apart or accumulate some of the funds received from voluntary contributions for certain specific purposes. The resultant benefit obtained by the trust is that amount so deducted is not considered as forming part of income of the previous year and therefore not taxed.

**Tax exemption for a Private Trust**

The taxability of the Trust depends upon the type of the trust. In the case of a non-discretionary trust, all income is taxable in the hands of the beneficiaries. But if the beneficiaries are minors, the income is to be clubbed with that of the parent with the higher income.

On the other hand, in the case of a discretionary trust, in which the shares of the beneficiaries are unknown and indeterminate, it is taxed in the hands of trust at the maximum marginal rate.

Section 161(1A) of the IT Act provides that if any part of the income of such a trust includes profits and gains from business, then the aforesaid principle of Section 161(1) would be

ignored and the entire income of the trust including any profits and gains from business would be liable to income tax at the maximum marginal rate.

Thus, tax planning requires that the trustee should not have any income in the nature of profits and gains from business in the trust otherwise the entire income of the trust would become liable to maximum marginal rate of tax.

## FORMATION OF TRUST

A Trust can be created by any person over 18 years of age and mentally sound and capable of understanding.

Before registration of a trust, the following aspects have to be decided:

(a) Name of the trust

(b) Address of the trust

(c) Objects of the trust (charitable or Religious)

(d) One settler of the trust

(e) Two trustees of the trust

(f) Property of the trust-movable or immovable property (normally a small amount of cash/cheque is given to be the initial property of the trust, in order to save on the stamp duty)

1. **Creation of a Trust Deed:** A trust may be created by any language sufficient to show the intention and no technical words are necessary. A trust may even be created by the use of words which are primarily words of condition, but such words will constitute a trust only where the requisites of a trust arc present. Though the use of the word 'trust' is not needed to create a valid trust, the terms of the grant or will make it clear that an obligation is actually annexed to the ownership of the trust property.

   A trust-deed, generally, incorporates the following:

   - the name(s) of the author(s)/settlor(s) of the trust;
   - the name(s) of the trustee(s);
   - the name(s) if any, of the beneficiary/ies or whether it shall be the public at large;
   - the name by which the trust shall be known;
   - the place where its principal and or other offices shall be situated;
   - the property that shall devolve upon the trustee(s) under the trust for the benefit of the beneficiary/ies;
   - an intention to divest the trust property upon the trustee(s);
   - the object and purpose of the trust;
   - the procedure for appointment, removal or replacement of a trustee, their rights, duties and powers, etc;
   - the rights and duties of the beneficiary/ies;

- ❖ the mode and method of determination of the trust.

2. Obtain the signatures of Settlor, Trustees and Witnesses at the appropriate places. Their photographs and Identity proof is also to be furnished. The Deed must be witnessed by at least two witnesses. The Settlor must sign all the pages of the Trust Deed.
3. Print the Trust Deed on stamp paper of appropriate value, depending on the stamp duty applicable in the State of execution.
4. Register the Original deed in a Sub-Registrar office paying registration charges: A photocopy of the Deed is also required to be submitted. The photocopy of the Deed should also contain the signature of settlor on all the pages.
5. At the time of registration, the settlor and witnesses must be personally present with their identity proof in original.
6. The Sub- Registrar retains the photocopy and returns the original copy of the Trust Deed.
7. Thereafter, the Trust can apply for a permanent account number for the trust and open a bank account for it as it is a separate entity.

## Registration of Trust

The requirements to register a trust deed are as follows:

i. Trust Deed on stamp paper – The value of the stamp paper is a certain percentage of the total property value belonging to the trust. The percentage differs from one state to another.

ii. Proof of Identity – Self-attested copies of ID proofs of the Trustor and the Trustees (passport/voter ID/Aadhar Card/Driving license)

iii. Address Proof of Registered office – Property Registration certificate or utility bill copy (water bill/electricity bill)

iv. No Objection Certificate (NOC) from the property owner – For rented property

v. Passport-sized photographs of the Trustor, the Trustees and the witnesses present while signing of the Deed.

| S. No. | Partnership Agreement | Trust Deed |
|---|---|---|
| 1. | Partners, as mentioned in the Deed runs the Partnership Firm. The procedure to admit a partner in the firm is mentioned in the Deed | Trustees are generally appointed or elected. Procedure to elects/ appoint the trustees is set out in Deed. |
| 2. | A partnership Deed can be between two or more persons. Maximum no. of partners in a partnership firm can be 50 partners. | Three parties must be involved with any deed of trust: Trustor: This party is the borrower. A trustor is sometimes called an obligor. Trustee: As a third party to a deed of trust, the trustee holds the property's legal title. Beneficiary: This party is the lender. |
| 3. | The Deed may mention a fixed term of partnership or for a specific undertaking, or may mention the condition of dissolution by notice of intention to dissolve, if mutually agreed by the partners. | Trust deed can provide for trust to be wound up within certain number of years. |
| 4. | The Deed states the rights and duties of the Partners. Partners owe a fiduciary duty to each other, based on loyalty, trust and confidence. | The Trust Deed states the rights and duties of the Trustees as well as Beneficiaries. Trustees have fiduciary duties to beneficiaries |
| 5. | Expectations of Partner are more limited to financial success of business ventures. More easily measured | Expectations of trustees can be high- difficult to satisfy beneficiaries with so many choices on where to spend income. |

## SOCIETY

A society is an association of persons united together by mutual consent to deliberate, determine and act jointly for some common purpose. Societies are usually registered for promotion of charitable activities like education, art, religion, culture, music, sports, etc., In India, The Societies Registration Act, 1860 lays down the procedure for society registration and operation in India. The Act has been adopted by most of the State Governments with/without modifications as considered by the respective State Governments.

According to Section 20 of the Societies Registration Act, 1860, societies can be formed for the following purposes:

i. Charitable societies;

ii. the military orphan funds or societies established at the several presidencies of India;

iii. societies established for the promotion of science, literature, or the fine arts for instruction, the diffusion of useful knowledge;

iv. The diffusion of political education;

v. the foundation or maintenance of libraries or reading-rooms for general use among the members or open to the public;

vi. public museums and galleries of paintings and other works of art, collections of natural history, mechanical and philosophical inventions, instruments, or designs.

Besides these purposes, the respective State Governments may provide for any other objects by their legislations.

## Advantages of Society

(a) The process of formation and registration is simple.

(b) Record-keeping requirements are minimum and compliance with regulations is easy.

(c) Cost of compliance is low.

(d) Least possibility of interference by the regulator.

(e) Exemption from tax due to charitable nature of operations.

## Disadvantages of Society

(a) Tax exemption extended to societies may apply to public trusts only to the extent the Income Tax department accepts their activities as being charitable;

(b) Since such institutions are of charitable nature, it is an inappropriate form of a commercial venture;

(c) The concept of equity investment or ownership is virtually absent; hence, it is not attractive for commercial investors interested in microfinance;

(d) Commercial investors regard the investments in such entities as risky mainly on account of their lack of professionalism and managerial practices and political leanings (in some cases) and are, therefore, reluctant to provide large scale funding to such bodies;

(e) In accordance with Section 45S of the RBI Act, 1934, no unincorporated bodies are allowed to accept deposits from the public. Organisations registered under the Societies Registration Act and the Trust Act are considered unincorporated bodies. Hence, legally speaking, they are not allowed to collect savings from their clients; and

(f) It is vulnerable to the implication under the Money Lenders Acts (prevention of usurious interest rates) of various State Governments.

## Formation of Society

Under Section 1 of the Societies Registration Act, 1860, any seven or more persons who have come together for any legal pursuits, including literary, scientific, charitable or social pursuits, may subscribe their names to a memorandum of association and file the same with the Registrar and form themselves into a society under this Act.

The memorandum of association filed with the Registrar should contain details such as the name and objectives of the society, names, addresses and occupations of the members of the governing body with which the management of the affairs of the society is entrusted. A copy of the rules and regulations of the society should be provided.

With the completion of these processes, the society could be registered with the Registrar after payment of a fee, which will be specified by the State Government from time to time. As per Section 4 of the Act, once in every year, an annual general meeting of the society should be conducted.

If the rules do not provide for an annual general meeting, a list of the names, addresses and occupations of the members of the governing body should be presented to the Registrar, every year.

- Registration can be done either at the state level (i.e., in the office of the Registrar of Societies) or at the district level (in the office of the District Magistrate or the local office of the Registrar of Societies)
- Memorandum of association and rules and regulations
- Consent letters of all the members of the managing committee
- Authority letter duly signed by all the members of the managing committee
- An affidavit sworn by the president or secretary of the society on non-judicial stamp paper of Rs.20-/,together with a court fee stamp
- A declaration by the members of the managing committee that the funds of the society will be used only for the purpose of furthering the aims and objects of the society
- The documents needed to be submitted to the Registrar are:

1. A letter requesting registration, signed by founding members. This letter will state the purpose of formation of the society and a requisition indicating that the society is registered under the Act. The signature of all members is mandatory.
2. A certified copy of the MoA, signed by the founding members, with a duplicate.
3. A certified copy of the rules and regulations, signed by the founding members, along with a duplicate copy.
4. A table with the names and address and occupation of all members of the society with their signatures.
5. Minutes of the meeting (general body meeting conducted to set the rules and regulations).
6. Declaration by the president of the society.
7. A sworn affidavit from the President or Secretary, declaring the relationship between the subscribers.

8. Address proof of registered office and no-objection certificate from the landlord.

The documents are to be filed with the Registrar along with the fees, and a suitable name (which should be unique and not suggest a relationship with the government or violate the provisions of the Emblem and Names Act, 1950). If the Registrar is satisfied with the application, the society will be registered.

## Benefits of forming a Society

1. Under Income Tax Act, and subject to fulfilment of certain conditions, a society can avail exemption from income tax, if it obtains registration under Section 12A/12AA of the Income Tax, 1961.
2. Donors to societies may claim a rebate under Income Tax Act for donations made to the Society, provided the society has applied and obtained approval under Section 80G. Registration under section 12A is one-time registration. Once the registration is granted to the trust, it will be hold good till the cancellation of registration. There is no provision which requires any renewal of registration. Thus, the benefits of registration can be claimed for lifetime by NGO.
3. Societies, being NGO's receive various grants from government and other agencies. They are eligible to get grants and financial funding from various agencies. These agencies generally make grants to societies registered under Section 12A.
4. Societies are run on democratic principles and ensures wider participation by members in the activities.
5. In view of the election process, there is scope for removing inefficient management and effect changes in the management to ensure better governance.

## Registration of a Society in India

A Society can be created by a minimum of 7 or more persons. Apart from persons from India, companies, foreigners, as well as other registered societies can also register for the Memorandum of the society.

Society registration is maintained by state governments. Thus, the application for society registration must be created to the specific authority of the state, where the registered office of society is situated.

For Society registration, the establishing members must agree with the name of society first and then prepare for the Memorandum, followed by Rules & Regulations of the society.

### Selection of a Name

When selecting a name for society registration, it is vital to understand that according to Society Registration Act, 1860, an identical or similar name of a currently registered society will not be allowed. Moreover, the proposed name shall not suggest any patronage of State Government or Government of India or contravene the provisions of the Emblem & Names Act, 1950. Memorandum of Association.

## Memorandum of Association

The Memorandum of society along with Rules & Regulations of society must be signed by every establishing member, witnessed by Gazetted Officer/Notary Public/ Chartered Accountant/ Oath Commissioner/ Advocate/ Magistrate first class /Chartered Accountant with their official stamping and complete address. The memorandum must also contain details of members of the society registration along with their names, addresses, designations, and occupations.

The following documents have to be prepared, submitted and signed for the sake of registration:

- Requesting society registration by providing covering letter, signed by all establishing members
- Duplicate copy of memorandum of association of society along with certified copy
- Duplicate copy of Rules & Regulations of society along with duplicate copy duly signed by all establishing members
- Address proof of registered office of society as well as no-objection certificate (NOC) issued by landlord
- Affidavit by secretary or president of society declaring relationship among subscribers
- Few minutes of meeting regarding the society registration along with providing some essential documents.

Following are the documents required for the Society Registration in India:

1. PAN Card of all the members of the proposed society has to be submitted along with the application.
2. The Residence Proof of all the members of the society also has to be submitted. The following can be used as a valid residence proof:
    - Bank Statement
    - Aadhaar Card
    - Utility Bill
    - Driving License
    - Passport
3. Memorandum of Association has to be prepared which will contain the following clauses and information: The work and the objectives of the society for which it is being established
    - The details of the members forming the society
    - It will contain the address of the registered office of the society
4. Articles of Association also have to be prepared which will contain the following information:
    - Rules and regulations by which the working of the society will be governed and the maintenance of day to day activities.
    - It will contain the rules for taking the membership of the society.

- The details about the meetings of the society and the frequency with which they are going to be held is to be mentioned.
- Information about the Auditors.
- Forms of Arbitration in case of any dispute between the members of the society.
- Ways for the dissolution of the society will also be mentioned once the rules have been formed, they can be changed but the new set of rules will be signed by the President, Chairman, Vice President and the Secretary of the Society.

5. A covering letter mentioning the objective or the purpose for which the society is being formed will be annexed to the beginning of the application. It will be signed by all the founding members of the society.
6. A copy of the proof of address where the registered office of the society will be located along with a NOC from the landlord if any has to be attached.
7. A list of all the members of the governing body has to be given along with their signatures.
8. A declaration has to be given by the president of the proposed society that he is willing and competent to hold the said post.

All the above documents have to be submitted to the Registrar of Societies along with the requisite fees in two copies. On receiving the application, the registrar will sign the first copy as acknowledgment and return it while keeping the second copy for approval. On proper vetting of the documents, the registrar will issue an Incorporation Certificate by allotting a registration number to it.

The signed Rules & Regulations, as well as Memorandum, has to be filed with concerned society or registrar of state with a mentioned fee. If the registrar is fulfilled with society registration application, then they will certify that the society is registered.

## Consequences of Registration / Non-Registration of a Society

The Societies Registration Act, 1860 lays down procedure for registration of societies for various bonafide purposes. The registration gives the society a legal status and is essential for:

- obtaining registration and approvals under Income Tax Act;
- lawful vesting of property in the societies;
- provides authenticity and recognition to the society before all authorities and the world at large; and
- for opening bank accounts and transaction of business.

When the society is registered, it along with its members become bound to the same extent, as if each member had signed the memorandum. Once registered under the Societies Registration Act, the society must restrict its activities to the objects contained in its Memorandum.

A society registered under the Act enjoys the status of a legal entity apart from the members constituting it. A society so registered is a legal entity/person similar to an individual but with no physical existence. As such it can acquire and hold property and can sue and be sued in its own name.

The society should be registered under the Act to acquire the status of juridical person.

In the absence of registration, all the trustees in charge of the fund have alone a legal status and the society has no legal status, and, therefore, it cannot sue and be sued.

If a society is not registered, it may exist in fact and theory, but not in the eyes of law. If benefits are to be claimed, the registration of society under the Act us required. An unregistered society cannot claim benefits under the Income-tax act.

## Accounts and Audits

The societies are in possession of funds and properties provided to them by the members or by other persons (by way of donation etc.). The funds and properties are to be applied in furtherance of its objects, for which the society was formed. The members of the governing body are the trustees who apply the funds.

Therefore, it becomes necessary for societies to maintain proper and regular account books and get them audited and present them to the members at the general meeting and file the same with the Registrar of Societies ( of the respective State where it is located) for scrutiny.

Every society should get its accounts audited once a year by duly qualified auditor and have balance sheet prepared by him.

## Litigation

As every society is a legal entity distinct from its members . It is capable of filing suits against any person or any member. Similarly, suits can also be filed against the society.

A registered society can file a suit anywhere in India and in any State although it may not be registered in that particular state.

## MEGA FIRM

Mega Firm or Multidisciplinary Firm (MDF) can be described as a Partnership firm with more than twenty-five partners. A firm which provides core professional service of a particular profession along with the allied and ancillary service with equal competence under one roof is a multidisciplinary firm. For example, company and corporate law is core knowledge for company secretaries, however, they can acquire expertise in any other area like direct-indirect taxation, labour laws, economic laws, finance, accounting, insurance, international business and IPRs and they may be in position to provide single window business solutions.

MDF is a step towards mega firm. It is paradigm shift from traditional approach of 10X10 offices to a global office. MDF will put the professionals in general and company secretaries in particular on fast track. Large firms will still become larger and one day the global business enterprise will call them a "Mega Firm".

Keeping in view of the present needs of the corporate and multi-dimensional growth of CS profession especially in the areas of practicing in the areas of Corporate Laws, Labour laws, RBI/ FEMA, acting as Secretarial Audit, Resolution Professional Insolvency Bankruptcy Code, GST Practitioner there is a need to structure and build the Multidisciplinary(MDF)/mega firms. There is a huge demand and scope for a multifunctional firm, where several services are provided under one roof. Clients always have a comfort level in dealing with such firms. They are assured of timely and quality service since even if one of the Partners is not available for consultancy they can bank on the others. Unless there are MDF/Mega firms, it may not be possible to cater to the bigger assignments. Multidisciplinary Firm – According to Regulation 165A of The Company Secretaries Regulations, 1982inserted by the Company Secretaries (Amendment) Regulations, 2020- A member in practice may form multidisciplinary firm with the member of other professional bodies as prescribed under regulations 168A and 168B of The Company Secretaries Regulations, 1982, in accordance with the regulating guidelines of the Council for functioning and regulation of such multidisciplinary firm.

## Regulation 168 A - Other Professional bodies:

1. For the purposes of clauses (2), (3) and (5) of Part I of the First Schedule to the Act, a person has to be member of any of the following, namely:
    a. The Institute of Chartered Accountants of India established under the Chartered Accountants Act, 1949;
    b. The Institute of Cost and Works Accountants of India established under the Cost and Works Accountants Act, 1959;
    c. Bar Council of India established under the Advocates Act, 1961;
    d. The Indian Institute of Architects established under the Architects Act, 1972;
    e. The Institute of Actuaries of India established under the Actuaries Act, 2006;
    f. The membership of the professional bodies or institutions whose qualifications relating to Company Secretaryship are recognized by the Council under Sub-section (2) of Section 38 of the Act.
2. For the purposes of clauses (2), (3) and (5) of Part I of the First Schedule to the Act, the following shall be the persons qualified in India, namely:
    a. Chartered Accountant within the meaning of the Chartered Accountants Act, 1949;
    b. Cost Accountant within the meaning of the Cost and Works Accountants Act, 1959;
    c. Actuary within the meaning of the Actuaries Act, 2006;
    d. Bachelor in Engineering from a University established by law or an institution recognized by law;
    e. Bachelor in Technology from a University established by law or an institution recognized by law;
    f. Bachelor in Architecture from a University established by law or an institution recognized by law;

g. Bachelor of Law from a University established by law or an institution recognized by law;

h. Master in Business Administration from Universities established by Law or Technical Institutions recognized by All India Council for Technical Education.

**Regulation 168B of Company Secretaries Regulations, 1982** determines the membership of professional body for partnership, accordingly for the purposes of entering into partnership under clauses (4) and (5) of Part I of the First Schedule to the Act, a person shall be a member of any of the following professional bodies, namely:

- The Institute of Chartered Accountants of India established under the Chartered Accountants Act, 1949;
- The Institute of Cost and Works Accountants of India established under the Cost and Works Accountants Act, 1959;
- Bar Council of India established under the Advocates Act, 1961;
- The Institute of Engineers or Engineering from a University established by law or an institution recognized by law;
- The Indian Institute of Architects established under the Architects Act, 1972;
- The Institute of Actuaries of India established, under the Actuaries Act, 2006;
- Professional bodies or institutions outside India whose qualifications relating to Company
- Secretary recognized by the Council under Sub-section (2) of Section 38 of the Act.

## Pre-requisites

MDF is a joint or collaborative venture amongst independent individuals. Therefore, every one wishing to join hands should understand that:

1. All minds should work together and in unison;
2. Say go to ego;
3. Mutual faith and respect lays strong foundation;
4. Unanimity shall be the rule on important policy decisions;
5. Financial discipline is a must;
6. Founder partners shall be given equal status;
7. Income of the firm shall be distributed at short regular intervals;
8. One shall not put undue influence on the others or show that he is king pin of the association. Even the small crack in the above stated pre requisites ruin the things.

## Benefits

The nature of a multidisciplinary firm fosters collaboration. The common office space, with professionals working in close proximity to one another, provides each professional with a strong set of resources in the firm.

In addition, this spirit of working together creates greater opportunity for collaboration so the total needs of the client are best met.

a) **Working in a team environment:** The concept of MDF will have an opportunity to work with team members who share interests, expertise, ideas, and work ethically.

b) **Good Exposure:** Every client has different expectations, needs, audience, products and services, so consultants get to oversee projects of all kinds. In MDF being more than two partners having different experience in different fields the apprentice and employee will have an exposure to various and different works. With each partners specialized knowledge the MDF may venture into new areas of practice.

c) **Cost effective:** With large investment budgets, the MDF have not only create state-of-the-art training facilities, they also may have much more developed infrastructure, processes and tools which can make your life less stressful when trying to sell or deliver a project. The overheads and the risks get distributed amongst the partners.

d) **Exceptional training and on-boarding:** MDF provides an opportunity to have a good training facilities whether on job training or off job training to get things started off on the right foot. The goal of on job training or off job training is to set you up for success, so during this training you can expect to receive the resources, knowledge, and tools to do so.

e) **Continuous Learning:** The partners of MDF having multi-dimensional experience they can impart continuous training by adapting to new trends in the Profession. The great thing about staying on your toes is that clients appreciate it because you'll be able to develop relevant and successful ideas. Though it might sound overwhelming to always be on top of news and trends, it will eventually become habit – and the results are worth it!

f) **Better Growth opportunities:** With the right work ethic and dedication, MDF can experience professional growth early compared to the other small firms. MDF may attract big multinationals. They get comfort about availability of at least one of the partners, if they are dealing with a firm rather than an individual. Senior partners can concentrate on critical assignments which obviously are more lucrative.

g) **Global scope and reach:** The MDF have an international or global scope and reach, offer diversified services and can draw from a large pool of consultants, skills and expertise, and hence become a Mega Firm.

h) **Revenue sharing:** By appropriate revenue sharing model a PCS who himself may not have subject expertise can get a share from the assignments of that subject being executed by others.

i) **Structure & Processes:** The structure for execution of works or assignments will be more systematic and the process will be cost effective due to the standard processes and procedure. The hiring and training of people will be more systematic there by productivity of the company will be improved.

j) **Corporate or Industry perception:** When considering different professional firms, the corporate client may be preferring to one of the familiar, renowned MDF having brand image. The MDF may appear like a known quantity and can draw from a large pool of partners and associates.

k) **Reputation & risk-adjusted value:** Many of the bigger client's organizations may prefer that "you never go wrong when hiring one of the MDF", since the renowned brands of the MDF are perceived as proxy for high levels of professionalism, quality and reputation. Credibility of the firm and brand gets established in long term.

## Process of Constitution

The process of formation of MDF shall be an outcome of conscious and sincere decision and it is essential that the like-minded professional should deliberate and take this decision. It shall be ensured that the proposed constituents have expertise in different disciplines. There could be series of meetings before MOU is reached. It is advisable to work under MOU for one year. This works as a cooling period and for better understanding each other such trial period help in getting acclimatised. Mutual faith and understanding is sine qua non. Time has to be given to understand the compatibility of the individuals to each other. Once the initial bridge is successfully crossed then formal partnership may be constituted on the agreed terms. It will be in the long term interest of the MDF to have all the founder partners on equal footing. Their intellectual level shall be at par. During the reasonable period individual practice existing if any, shall be introduced in the firm. When it is proposed to add new partner, apart from settling commercial terms, it is suggested that the MDF shall enter into MOU effective at least for one year with the proposed partner and after understanding each other's compatibility he or she may be admitted to the MDF.

### Agreement between partners

Partners must enter into a partnership agreement defining inter alia the process of decision making, allocation of duties, responsibilities, delegation of authorities, revenue sharing and exit route.

## Risks Involved

1. Lack of understanding and multiplicity of directions to the staff could be disastrous.
2. More cost on infrastructure and technology.
3. Dominance of senior partners over the younger partners.
4. Defining exit route is difficult.
5. Lack of transparency may lead to disputes.
6. If crack develops in mutual faith & trust, very difficult to cure.
7. Communication gap between partners.

One stop or single window solutions or services always attract clients or customers. We can witness that conventional shops are being replaced by big shopping malls. In the same manner there is need for corporate and business sector to have "service malls". It always works better for a business enterprise to have handy team of consultants, both from cost and management point of view. It is most likely that MDF giving professional advice considers all angles and dimensions rather than an advice only from one point of view. Well considered advice by MDF can add value to their clients. Off late, business enterprises have become professionally shroud and they always like to have a professional firm who is willing to invest in improving their knowledge of the industries they serve. MDF is the right platform that caters to the requirement of the business enterprises. With specialized partner, "knowledge management" becomes easier and less costly.

# Chapter 8 : Financial Services Organisation

## INTRODUCTION

India has a diversified financial sector undergoing rapid expansion, both in terms of strong growth of existing financial services firms and new entities entering the market. The sector comprises commercial banks, insurance companies, non-banking financial companies, co-operatives, pension funds, mutual funds and other smaller financial entities. The banking regulator has allowed new entities such as payments banks to be created recently thereby adding to the types of entities operating in the sector. However, the financial sector in India is predominantly a banking sector with commercial banks accounting for more than 64 per cent of the total assets held by the financial system.

NBFC is a financial Institution that is into Lending or Investment or collecting monies under any scheme or arrangement but does not include any institutions which carry on its principal business as agriculture activity, industrial activity, trading and purchase or sale of immovable properties. A company that carries on the business of accepting deposits as its principal business is also a NBFC.

The Government of India has introduced several reforms to liberalise, regulate and enhance this industry. The Government and Reserve Bank of India (RBI) have taken various measures to facilitate easy access to finance. These measures include (to name a few) launching different categories of Non Banking Finance Companies (NBFCs), Asset Reconstruction Companies (ARCs) and Micro Finance Institutions (MFIs).With a combined push by both government and private sector, India is undoubtedly one of the world's most vibrant capital markets.

Over the years, Non Banking Financial Companies (NBFC'S), Housing Finance Companies (HFC's), Asset Reconstruction Companies (ARC's), Micro Finance Institutions (MFI's), and Nidhi Companies have played a dominant role in mobilisation and disbursal of funds.

With the advent of mobile technology and vast strides made by the country in the field of information technology, Payment Banks has emerged as a new model of banks conceptualised by the Reserve Bank of India (RBI).

Financial Services Organisations Structure in India:

IC – Investment Company

AFC- Asset Finance Company

LC – Loan Company

IFC - Infrastructure Finance Company

CIC - Core Investment Company

MGC - Mortgage Guarantee Company

IDF- Infrastructure Debt Fund

MFI – Micro Finance Institution

NOFHC - Non-Operative Financial Holding Company

# NON-BANKING FINANCIAL COMPANY

A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, 2013 (or any earlier enactments) engaged in the business of loans and advances, acquisition of shares/stocks/bonds/ debentures/ securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire- purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/construction of immovable property. A non-banking institution which is a company and has principal business of receiving deposits under any scheme or arrangement in one lump sum or in instalments by way of contributions or in any other manner, is also a non-banking financial company (Residuary non-banking company).

Financial activity as principal business is when a company's financial assets constitute more than 50% of the total assets and income from financial assets constitute more than 50% of the gross income. A company which fulfils both these criteria will be registered as NBFC by RBI. Interestingly, this test is popularly known as 50-50 test and is applied to determine whether or not a company is into financial business.

NBFCs lend and make investments and hence their activities are akin to that of banks; however, there are a few differences as given below:

i. NBFC cannot accept demand deposits;
ii. NBFCs do not form part of the payment and settlement system and cannot issue cheques drawn on itself;
iii. deposit insurance facility of Deposit Insurance and Credit Guarantee Corporation is not available to depositors of NBFCs, unlike in case of banks.

## Systemically important NBFCs

NBFCs whose asset size is of Rs. 500 cr or more as per last audited balance sheet are considered as systemically important NBFCs. The rationale for such classification is that the activities of such NBFCs will have a bearing on the financial stability of the overall economy.

In the wake of failure of several banks in the late 1950s and early 1960s in India, large number of ordinary depositors lost their money. At this time, the Reserve Bank did note that there were deposit taking activities undertaken by non-banking companies. Though they were not systemically as important as the banks, the Reserve Bank initiated regulating them, as they had the potential to cause pain to their depositors. These institutions have thus been under the regulatory oversight of the Reserve Bank of India since 1963. Since then regulation has generally kept pace with the dynamism displayed by the sector. Later in 1996, in the wake of the failure of a big NBFC, the Reserve Bank tightened the regulatory structure over the NBFCs, with rigorous registration requirements, enhanced reporting and supervision.

In November 2014, the entire regulatory framework was reviewed with a view to transitioning, over time, to an activity based regulation of NBFCs. As a first step in this direction, certain changes to the regulatory framework are sought to be made to:

a) address risks wherever they exist,
b) address regulatory gaps and arbitrage arising from differential regulations, both within the sector as well as vis-a-vis other financial institutions,

c) harmonise and simplify regulations to facilitate a smoother compliance culture among NBFCs, and
d) strengthen governance standards.

## Regulatory and Supervisory Framework

The Regulatory and Supervisory Framework of the Reserve Bank provides for, among other things, registration of NBFCs, prudential regulation of various categories of NBFC, issue of directions on acceptance of deposits by NBFCs and surveillance of the sector through off-site and on-site supervision. Deposit taking NBFCs and Systemically Important Non-Deposit Accepting Companies are subjected to a greater degree of regulation and supervision. The focus of regulation and supervision is three fold, viz.,

a) depositor protection,
b) consumer protection and
c) financial stability.

The Reserve Bank has also been empowered under the RBI Act, 1934 to take punitive action which includes cancellation of Certificate of Registration, issue of prohibitory orders from accepting deposits, filing criminal cases or winding up petitions under provisions of Companies Act in extreme cases.

## Scale Based Regulatory Framework for NBFCs

Non-banking Finance Companies (NBFCs) plays a pivotal role in the economic growth of the country. The NBFC sector has undergone a significant transformation over the years and has created its own niche in supplying credit to retail customers in the relatively under-served and un-banked areas. In October 2021, RBI notified scale-based regulations for NBFCs, which is effective from 1st October, 2022. With these regulations, RBI aims to increase transparency in NBFC operations through greater disclosures and improved governance standards.

The revised framework envisages a progressive increase in the intensity of regulation and is thus visualized as a four-layer pyramid - a base layer, middle layer, upper layer, and top layer. With each layer, regulations become stricter.

**Base Layer:** The Base Layer shall comprise of non-deposit taking NBFCs below the asset size of Rs.1000 crore, Peer to Peer Lending Platform, Account Aggregator, Non-Operative Financial Holding Company and NBFCs not availing public funds and not having any customer interface.

**Middle Layer:** The Middle Layer shall consist of all deposit taking NBFCs, non-deposit taking NBFCs with asset size of Rs.1000 crore and above and NBFCs undertaking the activities of Standalone Primary Dealers, Infrastructure Debt Fund, Core Investment Companies, Housing Finance Companies and Infrastructure Finance Companies.

**Upper Layer:** The Upper Layer comprise of those NBFCs which require enhanced regulatory supervision. The top ten eligible NBFCs in terms of their asset size shall always reside in the upper layer, irrespective of any other factor.

Top Layer: The Top Layer is empty. This layer can get populated if the Reserve Bank is of the opinion that there is a substantial increase in the potential systemic risk from specific NBFCs in the Upper Layer. Such NBFCs shall move to the Top Layer from the Upper Layer.

## TYPES/CATEGORIES OF NBFCS

NBFCs are categorized as:

Within this broad categorization the different types of NBFCs are as follows:

**I. Asset Finance Company (AFC)**

An AFC is a company which is a financial institution carrying on as its principal business the financing of physical assets supporting productive/economic activity, such as automobiles, tractors, lathe machines, generator sets, earth moving and material handling equipments, moving on own power and general purpose industrial machines. Principal business for this purpose is defined as aggregate of financing real/physical assets supporting economic activity and income arising therefrom is not less than 60% of its total assets and total income respectively.

**II. Investment Company (IC)**

IC means any company which is a financial institution carrying on as its principal business the acquisition of securities.

**III. Loan Company (LC)**

LC means any company which is a financial institution carrying on as its principal business the providing of finance whether by making loans or advances or otherwise for any activity other than its own but does not include an Asset Finance Company.

**IV. Infrastructure Finance Company (IFC)**

IFC is a non-banking finance company -

a) which deploys at least 75 per cent of its total assets in infrastructure loans;
b) has a minimum Net Owned Funds of Rs.300 crore;
c) has a minimum credit rating of 'A' or equivalent; and
d) a CRAR of 15%.

**V. Systemically Important Core Investment Company (CIC-ND-SI)**

CIC-ND-SI is an NBFC carrying on the business of acquisition of shares and securities which satisfies the following conditions:-

a) it holds not less than 90% of its Total Assets in the form of investment in equity shares, preference shares, debt or loans in group companies;
b) its investments in the equity shares (including instruments compulsorily convertible into equity shares within a period not exceeding 10 years from the date of issue) in group companies constitutes not less than 60% of its Total Assets;
c) it does not trade in its investments in shares, debt or loans in group companies except through block sale for the purpose of dilution or disinvestment;
d) it does not carry on any other financial activity referred to in Section 45I(c) and 45I(f) of the RBI Act, 1934 except investment in bank deposits, money market instruments, government securities, loans to and investments in debt issuances of group companies or guarantees issued on behalf of group companies;
e) Its asset size is Rs. 100 crore or above; and
f) It accepts public funds.

## VI. Infrastructure Debt Fund: Non- Banking Financial Company (IDF-NBFC)

IDF-NBFC is a company registered as NBFC to facilitate the flow of long term debt into infrastructure projects. IDF-NBFC raise resources through issue of Rupee or Dollar denominated bonds of minimum 5-year maturity. Only Infrastructure Finance Companies (IFC) can sponsor IDF NBFCs.

IDFs are investment vehicles which can be sponsored by commercial banks and NBFCs in India in which domestic/offshore institutional investors, specially insurance and pension funds can invest through units and bonds issued by the IDFs. IDFs would essentially act as vehicles for refinancing existing debt of infrastructure companies, thereby creating fresh headroom for banks to lend to fresh infrastructure projects. IDF-NBFCs would take over loans extended to infrastructure projects which are created through the Public Private Partnership (PPP) route and have successfully completed one year of commercial production. Such take-over of loans from banks would be covered by a Tripartite Agreement between the IDF, Concessionaire and the Project Authority for ensuring a compulsory buyout with termination payment in the event of default in repayment by the Concessionaire.

## VII. Non-Banking Financial Company - Micro Finance Institution (NBFC-MFI)

"Non-Banking Financial Company – Micro Finance Institution (NBFC-MFI)" means a non-deposit taking NBFC (other than a company formed and registered under section 25 of the Companies Act, 1956 or Section 8 of the Companies Act, 2013) that fulfils the following conditions:

a) Reserve Bank of India specifies ten crore rupees as net owned fund (NOF) requirement for NBFCMFI with effect from October 01, 2022. However, existing non-banking financial companies holding a certificate of registration as on October 22, 2021 issued by the Reserve Bank of India and having net owned fund of less than ten crore rupees, shall achieve the NOF of Rs.10 crore as per the following glide path:
   - Rupees 7.00 Crores by March 31, 2025
   - Rupees 10.00 Crores by March 31, 2027

b) Not less than 85% of its net assets are in the nature of "qualifying assets" which satisfy the following criteria:
   i. Loan which is disbursed to a borrower with household annual income not exceeding Rs. 1,25,000 and Rs. 2,00,000 for rural and urban/semi-urban households, respectively;
   ii. Loan amount does not exceed Rs 75,000 in the first cycle and Rs 1,25,000 in subsequent cycles;
   iii. Total indebtedness of the borrower does not exceed Rs 1,25,000 (excluding loan for education and medical expenses);
   iv. Minimum tenure of 24 months for loan amount exceeding Rs 30,000;
   v. Collateral free loans without any prepayment penalty;
   vi. Minimum 50 per cent of aggregate amount of loans for income generation activities; and
   vii. Flexibility of repayment periodicity (weekly, fortnightly or monthly) at borrower's choice.

### VIII. Non-Banking Financial Company – Factors (NBFC-Factors)

NBFC-Factor is a non-deposit taking NBFC engaged in the principal business of factoring. The financial assets in the factoring business should constitute at least 50 percent of its total assets and its income derived from factoring business should not be less than 50 percent of its gross income.

### IX. Mortgage Guarantee Companies (MGC)

MGC are financial institutions for which at least 90% of the business turnover is mortgage guarantee business or at least 90% of the gross income is from mortgage guarantee business and net owned fund is Rs 100 crore.

X. **NBFC- Non-Operative Financial Holding Company (NOFHC)** is financial institution through which promoter/ promoter groups will be permitted to set up a new bank. It's a wholly-owned Non-Operative Financial Holding Company (NOFHC) which will hold the bank as well as all other financial services companies regulated by RBI or other financial sector regulators, to the extent permissible under the applicable regulatory prescriptions.

XI. **Systemically important non-deposit taking non-banking financial company** means a non-banking financial company not accepting / holding public deposits and having total assets of Rs 500 crore and above as shown in the last audited balance sheet;

## BENEFITS OF INCORPORATING AN NBFC

According to research and studies it is proved that NBFCs are outperforming banks. The continued better performance from NBFCs has given rise to an uptick of 15% customer satisfaction as compared to the banking customers. The same is agreed by the RBI according to the recent Financial Stability Report. Banks and Non- Banking Financial Companies (NBFCs) are financial intermediaries and the services offered by them are pretty much the same as banks. However, the benefits of incorporating an NBFC and carrying on its activities are listed below:

### 1. Competitive Interest Rates

Rate of interest is one of the main aspects of all types of loans. Non-Banking Financial Sectors have started to concentrate on this area in the recent decades and have brought down the interest rates to either equal to bank lending rates or at times even lower to bank rates. With all the other benefits when rate of interest is also lowered, borrowers found this more easy and affordable. This has also resulted in lower EMI (Equated Monthly Instalment) for borrowers. Based on the income, credit scoring and repayment, rate of interest is charged on the borrowers However it is at competitive rates.

### 2. Quick Processing

At banks, it is very important that the applicant should fulfil the eligibility criteria but NBFC are lenient in this aspect. This makes loan approval easier, smoother process and quicker. Most of the times, people apply for loan when they are in immediate need of money. NBFCs have taken this as an opportunity to meet the demand by quickly processing the loans at competitive rate of interest. At times, borrowers are even ready to compromise on the interest rates if the loan amount is huge and if they could get it approved quickly.

**3. Less Rules and Regulations**

As NBFC are incorporated under the Companies Act, (though regulated by the Reserve Bank of India), the rules and regulations for lending are not as stringent as banks. This helps borrowers to get loans easily. In view of less complicated loan processing requirements, borrowers are highly satisfied. Of course, the risk of default is high with NBFC and thus interest rates and other charges will be according priced by the NBFC. Even the loan amount approved will be quite lesser than the collateral value. This is due to the high risk of default. NBFCs do not have statutory reserve ratios and can open branches at will.

**4. Last Resort of Borrowing**

NBFCs are the largest propellants of ushering finance into the country. They are the last resorts of borrowing. Further, Agility is a key feature for NBFCs as it sets the banks apart. Banks functions slower as compared to the NBFCs.

**5. Caters Customer needs**

Another major advantage of NBFCs is the ground level understanding of their customer's profile and the need for their credit, which gives them an edge, as their ability to customize their products according to client needs. The continued better performance from NBFCs has given rise to an uptick of 15% customer satisfaction.

**6. Loan available for Individuals with Poor Credit Rating**

Individuals with poor credit rating generally will not get loans from banks. The reason for this is banks consider borrowers are high-risk individuals if the credit scoring is low. Unless the credit score is above 600 -650, it is very difficult to get a loan sanctioned from banks. On the other hand, loans will be offered to individuals with low credit score by NBFCs but most of the time the interest rates for such borrowers will be higher than market rates. Due to these aforementioned advantages, most of the NBFCs are growing.

With regard to offering loans, banks and NBFCs will offer business, personal and retail loans. And this is totally on the basis of the repayment capacity of the borrower. Most of the corporate sector prefers banks; however retail sector chooses NBFCs over banks. Simple loans such are vehicle financing loans, gold loans, home loans and durable loans are offered by NBFCs and customer satisfaction ratio is high here. NBFC sector is also set to expand even further in the coming days.

## INCORPORATION OF NBFCS

The enactment of Companies Act, 2013 impacted many areas including banks and NBFCs. However, there have been no major changes in incorporating the NBFCs under the new act. Accordingly, Non- Banking Financial Companies (NBFCs) are companies incorporated under Companies Act, 2013 or Companies Act, 1956.

The procedure for incorporating a Non-Banking Finance Company (NBFC) is the same as any other company through web form SPICE+. Their principal business, to be stated in the MOA, while registering under the Companies Act shall be lending credit, making investments in various types of shares and stocks, leasing, hire-purchase, insurance business, chit business, and receiving deposits under any scheme or arrangement.

## Registration Process with Reserve Bank of India

In terms of Section 45-IA of the RBI Act, 1934, no non-banking financial company shall commence or carry on the business of a non-banking financial institution without–

a) obtaining a certificate of registration issued by the Bank; and
b) having the net owned fund of twenty-five lakh rupees or such other amount, not exceeding hundred crore rupees, as the Bank may, by notification in the Official Gazette, specify.

Further, in terms of the powers given to the Reserve Bank, to obviate dual regulation, certain categories of NBFCs which are regulated by other regulators are exempted from the requirement of registration with RBI viz. Venture Capital Fund/Merchant Banking companies/Stock broking companies registered with SEBI, Insurance Company holding a valid Certificate of Registration issued by IRDA, Nidhi companies as notified under Section 620A of the Companies Act, 1956 or formed under section 406 of the Companies Act, 2013, Chit companies as defined in clause (b) of Section 2 of the Chit Funds Act, 1982, Housing Finance Companies regulated by National Housing Bank, Stock Exchange or a Mutual Benefit company.

## Registration Procedure

After incorporation of the company, the NBFC must obtain certificate of registration. Before applying for registration, the company should ensure the following:

a) It should have minimum one director from NBFC background or senior Bankers as full-time director in the company
b) Clean CIBIL records
c) Understanding of NBFC / Finance business.

Every non-banking financial company shall make an application for registration to the Bank in such form as the Bank may specify.

The Bank, for the purpose of considering the application for registration, may require to be satisfied by an inspection of the books of the non-banking financial company or otherwise that the following conditions are fulfilled:–

a) that the non-banking financial company is or shall be in a position to pay its present or future depositors in full as and when their claims accrue;
b) that the affairs of the non-banking financial company are not being or are not likely to be conducted in a manner detrimental to the interest of its present or future depositors;
c) that the general character of the management or the proposed management of the non-banking financial company shall not be prejudicial to the public interest or the interests of its depositors;
d) that the non-banking financial company has adequate capital structure and earning prospects;
e) that the public interest shall be served by the grant of certificate of registration to the nonbanking financial company to commence or to carry on the business of India;
f) that the grant of certificate of registration shall not be prejudicial to the operation and consolidation of the financial sector consistent with monetary stability, and economic growth considering such other relevant factors which the Bank may, by notification in the Official Gazette, specify; and

g) any other condition, fulfilment of which in the opinion of the Bank, shall be necessary to ensure that the commencement of or carrying on of the business in India by a non-banking financial company shall not be prejudicial to the public interest or in the interests of the depositors.

The Bank may, after being satisfied that the above specified conditions are fulfilled, grant a certificate of registration subject to such conditions which it may consider fit to impose.

The Bank cancel a certificate of registration granted to a non-banking financial company under this section if such company–

i. ceases to carry on the business of a non-banking financial institution in India; or
ii. has failed to comply with any condition subject to which the certificate of registration had been issued to it; or
iii. at any time fails to fulfil any of the conditions referred to in clauses (d) to (g) of sub-section (4); or
iv. fails–
    a) to comply with any direction issued by the Bank under the provisions of this Chapter; or
    b) to maintain accounts in accordance with the requirements of any law or any direction or order issued by the Bank under the provisions of this Chapter; or
    c) to submit or offer for inspection its books of account and other relevant documents when so demanded by an inspecting authority of the Bank; or
v. has been prohibited from accepting deposit by an order made by the Bank under the provisions of this Chapter and such order has been in force for a period of not less than three months:

Provided that before cancelling a certificate of registration on the ground that the non-banking financial company has failed to company with the provisions of clause (ii) or has failed to fulfil any of the conditions referred to in clause (iii) the Bank, unless it is of the opinion that the delay in cancelling the certificate of registration shall be prejudicial to public interest or the interest of the depositors or the non-banking financial company, shall give an opportunity to such company on such term as the Bank may specify for taking necessary steps to comply with such provision or fulfilment of such condition:

Provided further that before making any order of cancellation of certificate of registration, such company shall be given a reasonable opportunity of being heard.

A company aggrieved by the order of rejection of application for registration or cancellation of certificate of registration may prefer an Appeal, within a period of thirty days from the date on which such order of rejection or cancellation is communicated to it, to the Central Government and the decision of the Central Government where an appeal has been preferred to it, or of the Bank where no appeal has been preferred, shall be final:

Provided that before making any order of rejection of appeal, such company shall be given a reasonable opportunity of being heard.

## Procedure for filing application with Reserve Bank of India

1. The applicant company is required to apply online and submit a physical copy of the application along with the necessary documents to the Regional Office of the Reserve Bank of India.
2. The application can be submitted online by accessing RBI's secured website https://cosmos.rbi.org.in. At this stage, the applicant company will not need to log on to the COSMOS application and hence user ids are not required.
3. The company can click on "CLICK" for Company Registration on the login page of the COSMOS Application. A window showing the Excel application form available for download would be displayed. The company can then download suitable application form (i.e. NBFC or SC/RC) from the above website, key in the data and upload the application form.
4. The company may note to indicate the correct name of the Regional Office in the field "C-8" of the "Annex- Identification Particulars" in the Excel application form. The company would then get a Company Application Reference Number (CARN) for the CoR application filed on-line.
5. Thereafter, the company has to submit the hard copy of the application form (indicating the online Company Application Reference Number) along with the supporting documents, to the concerned Regional Office.
6. The company can then check the status of the application from the above mentioned secure address, by keying in the acknowledgement number.

Note: The documents required may vary depending on the category of registration sought by the applicant.

## Documents required for registration as Type I - NBFC-ND

Requirements to be complied with and documents to be submitted to RBI by Companies for obtaining certificate and Registration from RBI as NBFC

1. Certified copies of Certificate of Incorporation and Certificate of Commencement of Business in case of public limited companies.
2. Certified copies of extract of only the main object clause in the MOA relating to the financial business.
3. Board resolution stating that:
   - the company is not carrying on any NBFC activity/stopped NBFC activity and will not carry on/ commence the same before getting registration from RBI.
   - the UIBs in the group where the director holds substantial interest or otherwise has not accepted any public deposit in the past /does not hold any public deposit as on the date and will not accept the same in future.
   - the company has formulated "Fair Practices Code" as per RBI Guidelines.
   - the company has not accepted public funds in the past/does not hold any public fund as on the date and will not accept the same in the future without the approval of Reserve Bank of India.
   - the company does not have any customer interface as on date and will not have any customer interface in the future without the approval of Reserve Bank of India.

4. Copy of Fixed Deposit receipt & bankers certificate of no lien indicating balances in support of NOF.
5. For companies already in existence, the Audited balance sheet and Profit & Loss account along with directors & auditors report or for the entire period the company is in existence, or for last three years, whichever is less, should be submitted.
6. Banker's report in respect of applicant company, its group/subsidiary/associate/holding company/ related parties, directors of the applicant company having substantial interest in other companies.

   The Banker's report should be about the dealings of these entities with these bankers as a depositing entity or a borrowing entity.

For different forms of application as applicable to different categories of NBFC's, please refer to the official website of the Reserve Bank of India, viz., www.rbi.org.

## HOUSING FINANCE COMPANIES

Housing Finance Company (HFC) is a type of non-banking financial institution which is primarily engaged in the business of providing home loans and other related products. Unlike other Non-Banking Financial Companies which are governed under the regulatory framework of RBI, HFCs are regulated by the National Housing Bank (NHB).

Collateral securities are accepted against loans advanced by HFCs which include the property for which loan has been granted and some other collaterals as well. Since properties serve as the underlying asset on which financing is given, the amount of loan advanced depends upon the value of the collateral offered. The value of the collateral ensures that the lender is secured and has covered itself from the risk of default. Hence, correct and realistic valuation of properties or fixed assets becomes necessary at the time of advancement of loan. Further, loans given by HFCs are usually for a long period of time. Though the value of property is less volatile but there are chances that the same may fluctuate during the loan tenure. Usually after a loan has been granted, HFCs do regular property valuation to understand how the property value is changing. There is a need for revaluation at regular intervals so that the lender is assured of little or no deviation in the Loan to Value (LTV) ratio and also that the property is valued at its current fair market value.

A Housing Finance Company (HFC) is a company registered under the Companies Act, 2013 or any earlier enactment which primarily transacts or has as one of its principal objects, the transacting of the business of providing finance for housing, whether directly or indirectly. In addition to it being a company registered under the Companies Act, an HFC also requires registration with National Housing Bank (NHB) for commencing or carrying on the business of housing finance. The National Housing Bank was set up under the National Housing Bank Act, 1987. Housing Finance Companies are governed by the said Act and by Circulars, Guidelines, Notifications and Directions issued by National Housing Bank.

### Eligibility Criteria for Obtaining Housing Finance Company Registration

Based on the provisions of section 29A of the National Housing Bank Act 1987, no Housing Finance Company shall start to carry out its operations of providing housing loans unless the same had met all the accompanying guidelines.

- **Must be an NBFC:** The business entity that wants to operate as a Housing Finance Company must acquire registration as the Non-Banking Financial Company from the Apex Bank, i.e. RBI.
- **Net Owned Funds:** It shall be noted that the Net owned fund of a Housing Finance Company must be at least Rs 20 Crores. Therefore, an applicant needs to satisfy the requirements of net worth for obtaining Housing Finance Company Registration.
- **Must be registered under the Companies Act 2013:** The said Company requires to satisfy the requirements of a private limited company under the provisions of the Companies Act 2013 or the Companies Act 1956.
- **Housing Finance Activities as Object Clause:** It is the last but the most important requirement of all that the objects of this type of company must mention for financing housing loans and other commercial complexes. Besides providing finance, the said company must also have the predictions of earning.

The management and operations of the company must act in good faith and in the interest of the public and other consumers. That means they need to work in the interests of the public.

The regulatory power of the Housing Finance Companies (HFCs) was transferred from National housing Bank to Reserve Bank of India by the Central Government with effect from 09 August 2019. It was further submitted that the RBI would regulate the framework for HFCs and determine the extent to which rules can be subjected to HFCs and till this particular point of time the HFCs were directed to comply with the instructions as issued by NHB.

On 22 October 2020, the RBI issued the revised regulatory framework ("Revised Framework") for HFCs. Set out below are the key aspects of the Revised Framework:

"Housing finance company" shall mean a company incorporated under the Companies Act, 2013 that fulfils the following conditions:

a. It is an NBFC whose financial assets, in the business of providing finance for housing, constitute at least 60% of its total assets (netted off by intangible assets).
b. Out of the total assets (netted off by intangible assets), not less than 50% should be by way of housing financing for individuals.

"Housing Finance" shall mean financing, for purchase/ construction/ reconstruction/ renovation/ repairs of residential dwelling units, which includes:

a. Loans to individuals or group of individuals including co-operative societies for construction/ purchase of new dwelling units.
b. Loans to individuals or group of individuals for purchase of old dwelling units.
c. Loans to individuals or group of individuals for purchasing old/ new dwelling units by mortgaging existing dwelling units.
d. Loans to individuals for purchase of plots for construction of residential dwelling units provided a declaration is obtained from the borrower that he intends to construct a house on the plot within a period of three years from the date of availing of the loan.
e. Loans to individuals or group of individuals for renovation/ reconstruction of existing dwelling units.
f. Lending to public agencies including state housing boards for construction of residential dwelling units.

g. Loans to corporates/ Government agencies for employee housing.
h. Loans for construction of educational, health, social, cultural or other institutions/ centres, which are part of housing projects and which are necessary for the development of settlements or township.
i. Loans for construction meant for improving the conditions in slum areas, for which credit may be extended directly to the slum-dwellers on the guarantee of the Central Government, or indirectly to them through the State Governments.
j. Loans given for slum improvement schemes to be implemented by Slum Clearance Boards and other public agencies.
k. Lending to builders for construction of residential dwelling units.

All other loans including those given for furnishing dwelling units, loans given against mortgage of property for any purpose other than buying/ construction of a new dwelling unit/s or renovation of the existing dwelling unit/s as mentioned above, will be treated as non-housing loans and will not be falling under the definition of "Housing Finance".

**Net Owned Fund (NOF) Requirement**

In exercise of the powers conferred by clause (b) of sub-section (1) of Section 29A of the National Housing Bank Act, 1987, and all powers enabling it in that behalf, the Reserve Bank hereby specifies Rupees twenty crore as the minimum net owned funds required for a company to commence housing finance as its principal business or carry on the business of housing finance as its principal business.

Provided that a housing finance company holding a Certificate of Registration (CoR) and having net owned fund of less than Rupees twenty crore, may continue to carry on the business of housing finance, if such company achieves net owned fund of Rupees fifteen crore by March 31, 2022 and Rupees twenty crore by March 31 2023.

It will be incumbent upon such HFCs whose NOF currently stands below Rupees twenty crore, to submit a statutory auditor's certificate to Reserve Bank within a period of one month evidencing compliance with the prescribed levels as at the end of the period indicated above. HFCs failing to achieve the prescribed level within the stipulated period shall not be eligible to hold the Certificate of Registration (CoR) as HFCs and registration for such HFCs shall be liable to be cancelled. Such companies, who wish to be treated as NBFC – Investment and Credit Companies (NBFC-ICCs), will be required to approach RBI for conversion of their CoR from HFC to NBFC- ICC. Application for such conversion should be submitted with all supporting documents meant for new registration together with an auditor's certificate on principal business criteria (PBC) and necessary Board resolution approving the conversion.

"Net Owned Fund" means net owned fund as defined under Section 29A of the National Housing Bank Act, 1987 including paid up preference shares which are compulsorily convertible into equity.

## Benefits of incorporating a Housing Finance Company

1. Among the financial services, housing finance creates employment, both directly and indirectly.
2. Industries such as cement, brick manufacturing, sanitary products, electrical fittings and glass industries experience more demand due to house construction.

3. Rural housing develops not only rural areas but prevents migration of labor to urban areas.
4. Housing finance helps in creation of more houses which results in building up more infrastructure facilities, such as roads, electricity generation, drinking water facilities, etc.
5. Factories or industrial establishments create townships by providing more housing facilities to their employees. Housing finance thereby reduces congestion in urban areas.
6. Due to housing finance, there is a vertical expansion and re building of dilapidated houses and re-modelling of the existing houses.
7. Housing facilities not only improve, they also reflect the culture of the country. Chandigarh city is an example for modern housing which has been built by a French architect.
8. Non conventional energy gets popularized due to modern housing facilities which is one of the major benefits of housing finance.
9. At present, the macro environment is extremely favourable for housing finance companies. The Modi government's incentives in terms of allocation related to Pradhan Mantri Awas Yojana (PMAY) of Rs. 23,000 crore would provide the much-needed momentum to the sector. The total allocation for the infrastructure sector in the Budget stood at Rs 39,6135 crore in 2017-18.
10. The holding period for capital gains tax in case of immovable properties has been reduced from three to two years. Moreover, the Finance Minister has proposed to shift the base year for indexation from 1.4.1981 to 1.4.2001 for all classes of assets, including immovable property. This step would allow more realistic calculation of the cost of acquisition of the house while claiming indexation benefits.
11. It is expected that with several associated benefits and the advantage of digital documents, the cost of finance is expected to come down, which may be passed on to the real buyers.
12. In the days to come, supported by growth drivers such as rising disposable income, personal income tax benefits, increasing urbanisation and economic growth of tier II and tier-II cities, the sector is likely to see immense growth.

## Housing Finance Company: Registration Process

The following procedure must be followed by the applicant for housing finance company registration:

First the applicant has to download the application form for Housing Finance company registration from the website nhb.org.in.

All the documents must be attached along with the application. The demand draft in favour of the NHB also must be attached. This must be submitted in the Head Office of the NHB.

The NBH would check the authenticity of the application. If the documents provided are sufficient then the NBH would go ahead and register the housing finance company. The procedure for incorporating a Housing Finance Company (HFC) is the same as any other company.

NHB after satisfying itself on the fulfilment of following conditions provided under sub-section (4) of Section 29A of the National Housing Bank Act, 1987 may grant a Certificate of Registration:

i. HFC is or shall be in a position to pay its present or future depositors in full as and when their claims accrue;
ii. Affairs of the HFC are not being or are not likely to be conducted in a manner detrimental to the interest of its present or future depositors;
iii. General character of the management or the proposed management of the HFC shall not be prejudicial to the public interest or to the interests of its depositors;
iv. HFC has adequate capital structure and earning prospects;
v. Public interest shall be served by the grant of certificate of registration to the HFC to commence or carry on the business in India;
vi. Grant of certificate of registration shall not be prejudicial to the operation and growth of the housing finance sector of the country; and
vii. Any other condition, fulfilment of which in the opinion of the Reserve Bank, shall be necessary to ensure that the commencement of or carrying on the business in India by a HFC shall not be prejudicial to the public interest or in the interests of the depositors.
viii. The Reserve Bank may, wherever it considers necessary so to do, require the National Housing Bank to inspect the books of such housing finance institution and submit a report to the Reserve Bank for the purpose of considering the application.
ix. The Reserve Bank may, after being satisfied that the conditions specified in sub-section (4) are fulfilled, grant a certificate of registration subject to such conditions which it may consider fit to impose.

HFCs are categorized in terms of the type of liabilities, by NHB, into Deposit and Non-Deposit accepting HFCs and are issued Certificate of Registration accordingly.

## Net Owned Fund

According to the Explanation to Section 29A Net Owned Funds means:

a) The aggregate of the paid-up equity capital and free reserves as disclosed in the latest balance sheet of the housing finance institution after deducting therefrom -
   i. accumulated balance of loss;
   ii. deferred revenue expenditure, and
   iii. other intangible assets; and

b) further reduced by the amounts representing –
   i. investments of such institution in shares of
      - its subsidiaries;
      - companies in the same group;
      - all other housing finance institutions which are companies; and
   ii. the book value of debentures, bonds, outstanding loans and advances (including hire-purchase and lease finance) made to, and deposits with -
      - subsidiaries of such company; and
      - Companies in the same group, to the extent such amount exceeds ten per cent of (a) above;

"subsidiaries" and "companies in the same group" shall have the same meanings assigned to them in the Companies Act.

The applicant company is required to submit a physical copy of the application (in duplicate) along with the essentials documents to the Head Office of the National Housing Bank. Further, Company is also required to attach a Demand Draft for Rupees 10,000 favouring National Housing Bank payable at New Delhi.

## Conditions pertaining to the cancellation of the Housing Finance Company License

The Certificate of registration granted to a housing finance company may be cancelled in some of the circumstances subject to certain provisions, if such company:

- Ceases to carry on the business of financing in India; or
- HFC has not complied with the below-mentioned terms and condition prescribed by the NHB:
  - to comply with any direction issued by the National Housing Bank under the provisions of Chapter V of the National Housing Bank Act 1987; or
  - to maintain accounts in accordance with the requirement of any law or any direction or order issued by the National Housing Bank under the provisions of Chapter V of the National Housing Bank Act 1987; or
- Mandatory to submit its books of accounts and other relevant documents as per NHB Act, when it is demanded by an inspecting authority of the National Housing Bank; or
- Has been prohibited from accepting deposit by an order made by the National Housing Bank under the provisions of this Chapter V of the National Housing Bank Act, 1987 and such order has been in force for a period of not less than 3 months.

## ASSET RECONSTRUCTION COMPANY (ARC)

India has a vast banking industry with the primary function of lending and borrowing money. Banks take all precautions to lend their money to only those customers who can repay them. However, there can be cases when a customer defaults on their payment. And the bank suffers a loss from such a customer. It creates a massive amount of defaulters with the banks or financial institutions. The majority of unsuccessful businesses have to shut down because of financial pressure.

To minimise this loss, asset reconstruction companies come into the picture. When the customer becomes a defaulter, the bank can reduce its loss by giving away such default companies to the asset reconstruction companies (ARCs) at agreed values. It helps in cleaning the balance sheets of banks and financial institutions. Asset Management Companies in other countries perform many of the same functions as ARCs in India. India's first ARC was a company named ARCIL. It has been a pioneer in this field, having established industry standards for the rest of the market to follow.

In India, the problem of recovery from Non Performing Assets (NPAs) was recognized in 1997 by Government of India. The Narasimhan Committee Report mentioned that an important aspect of the continuing reform process was to reduce the high level of NPAs as a means of banking sector reform. It was expected that with a combination of policy and institutional development, new NPAs in the future could afford to be lower. However, the huge backlog of existing NPAs continued to hound the banking sector and this impinged severely on the banks

performance and any ensuing hopes of their profitability. The Report envisaged creation of an "Asset Recovery Fund" to take the NPAs off the lenders books at a discount.

Asset Reconstruction Company (Securitization Company / Reconstruction Company) is a company registered under Section 3 of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SRFAESI) Act, 2002. It is regulated by Reserve Bank of India as a Non-Banking Financial Company (u/s 45I (f) (iii) of RBI Act, 1934). RBI has exempted ARCs from the compliances under section 45-IA, 45-IB and 45-IC of the Reserve Bank Act, 1934. ARC functions like an AMC within the guidelines issued by RBI.

ARC has been set up to provide a focused approach to Non-Performing Loans resolution issue by: -

(a) Isolating Non-Performing Loans (NPLs) from the Financial System (FS),

(b) Freeing the financial system to focus on their core activities, and

(c) Facilitating development of market for distressed assets.

As per RBI Notification No. DNBS.2/CGM (CSM)-2003, dated April 23, 2003, ARC performs the following functions: -

i. Acquisition of financial assets (as defined u/s 2(L) of SRFAESI Act, 2002)
ii. Change or takeover of Management / Sale or Lease of Business of the Borrower
iii. Rescheduling of Debt
iv. Enforcement of Security Interest (as per section 13(4) of SRFAESI Act, 2002)
v. Settlement of dues payable by the borrower

Asset Reconstructions companies are created to manage and recover Non Performing Assets acquired from the banking system. Asset Reconstruction Companies are act as a bad bank by isolating Non Performing Assets from the balance sheet of bank/FII and facilitate the latter to concentrate in normal banking activities. Banks and financial institutions with a large proportion of their bad loans or Non-Performing Assets can sell to a separate entity i.e. Asset Reconstruction Company. Then Asset Reconstruction Companies recover a sum through attachment, liquidation etc. The objective is to help banks in making clean books by reducing Non Performing Assets. Asset Reconstruction Companies are also making profit by buying Non Performing Assets at a lower price.

## Asset Reconstruction

Let us understand the meaning of asset reconstruction:

- When banks grant loans, advances or are involved in lending, the bank has some right or interest in that transaction.
- When the ARCs take the bad assets, all such rights or interests are also transferred.
- The asset reconstruction company can then realise all such rights and interests.
- The financial assistance that can be over by the asset reconstruction companies is loans, advances, bonds, guarantees and other credit facilities.

**Securitisation:** When an asset reconstruction company acquires financial assets, a kind of security receipt is issued to the qualified buyers. This security receipt means an undivided interest in the financial assets.

## Benefits of incorporating an Asset Reconstruction Company (ARC)

- As the cash realisation activity from defaulting borrowers is a lengthy and cumbersome procedure, relieving banks of the burden of NPAs will allow them to focus better on managing the core business including providing new business opportunities for the ARC.
- The transfer should help restore depositor and investor confidence by ensuring the lender's financial health. The banks use it as a method to hive off the bad loans from their balance sheet. ARCs can maximize recovery value while minimizing costs.
- ARCs also helps building industry expertise in loan resolution and restructuring management, besides serving as a catalyst for important legal reforms in bankruptcy procedures and loan collection.
- ARCs play an important role in developing capital markets through secondary asset instruments.

## Asset Reconstruction Company – the Registration Process

Conditions for Registering an Asset Reconstruction Company

There are specific conditions or eligibility criteria for registering an ARC. The following criteria have to be sufficed for this:

1. The company must be registered as a company under the Companies Act, 2013.
2. After the company is formed, it must be eligible for registration under the RBI under the respective statutory legislation.
3. There should not be any losses incurred by the company in the previous or preceding three financial years.
4. If there is a process for the realisation of assets, then sufficient arrangement must be carried out for the purpose of securitisation and asset reconstruction.
5. The ARC must be able to pay all the periodical returns.
6. The company must be capable of redeeming the amount of investment which is made by qualified buyers and other investors in the company.
7. Directors must have sufficient experience and exposure in matters related to financial affairs which include reconstruction, insolvency, financial assets and other areas related to regulation.
8. There must be no criminal convictions against the directors. The directors and shareholders should not have committed any acts which affect their moral turpitude. Any acts which would lead to prosecution would also be covered.
9. All the key management executives or individuals should pass the requirements related to the fit and proper person test in order to comply with the requirements of the act. The requirements related to the fit and proper test would be notified by the RBI from time to time. This criteria and requirement would also be applicable to the sponsors of the company.
10. The entity is responsible for complying with the financial and prudential norms as set by the RBI.
11. There are specific guidelines which have to be followed by the RBI for registration of Asset Reconstruction Company in India.

As long as the above criteria or requirements have been met by the asset reconstruction company, the applicant could go ahead with the process of registration.

**Documents Required for Registration of an Asset Reconstruction Company**

The following documents are required for registering an ARC:

1. Certificate of Incorporation of the Company
2. Memorandum of Association and Articles of Association of the Company
3. Resolutions stating that the company has not taken or accepted any form of deposits. These resolutions would be applicable by the board of the company
4. Information that the directors are not disqualified as per the provisions of the Companies Act
5. Information and profiles related to the sponsors of the company
6. Information related to the management of the company. The management of the company would include the shareholders and directors of the company
7. Certified Copy related to the certificate of audit by the auditor of the company
8. Copy of the audited balance sheet of the company
9. Copy of the directors and auditor's report of the company
10. Net Owned Funds of the Company
11. Detailed Information on Related Party Transactions (RPT).

## MICRO FINANCE INSTITUTIONS (MFI)

As the name implies, microfinance institutions are bankers and lenders who provide microfinance services, such as deposits, loans, payment services, money transfers, and insurance. Basically, a micro finance institution is an organization that offers financial services to low income populations. Almost all give loans to their members, and many offer insurance, deposit and other services. Organisations which finance on a larger scale are regarded as regarded as microfinance institutes. They are those that offer credits and other financial services to the representatives of poor strata of population (except for extremely poor strata). An increasing number of microfinance institutions (MFIs) are seeking non-banking finance company (NBFC) status from RBI to get wide access to funding, including bank finance.

NABARD has defined microfinance as "provision of thrift, credit and other financial services and products of very small amounts to the poor in rural, semi-urban and urban areas provided to customers to meet their financial needs; with only qualification that (1) transactions value is small and (2) customers are poor."

Due to low security and increasing operating costs, many traditional banks were not willing to provide loans to the poor in India. This led to the development & growth of microfinance institutions in the country.

**Characteristics of a Micro Finance Institution**

1. Micro finance provides financial services to those whose income is small and unstable. These people are in need of credit facilities for several reasons. To name a few:
   a) heir needs are small and arise suddenly.
   b) the institutional providers of finance, namely, the banks, demand collateral security which they cannot provide.

c) most of the time, they are in urgent need of funds to meet their consumption demands, for example, to meet expenses related to education, illness, funerals, weddings for which it is difficult to obtain institution finance.
d) for purpose of investment in income generating activities.

2. Concept of Self Help Group (SHGs) is the most exciting discovery in the context of microfinance. The Indian microfinance scene is dominated by SHGs and their linkage with banks. This has helped in empowerment of women and eradication of property among people with low income.
3. Microfinance provides a greater menu of options whereby the small loan can be garnered not just from the external sources but also through self-mobilization, by way of saving and sale of assets.
4. The biggest flexibility in the case of microfinance is the lack of any physical collateral, even in case of loan from the bank.

The characteristics of MFIs may be summarised as under:

i. The size of the loan given by the MFI is small.
ii. The repayment period is short.
iii. MFI can mobilise resources both from internal and external sources.
iv. No collateral for loan is required.
v. the purpose of end use of loan is flexible.
vi. loans given are mostly group loans, trickling down to individuals.
vii. Transaction cost is low, due to group lending.

## Incorporation of MFI

Firstly, a company has to be incorporated under the Companies Act, 2013. The company may be a private company or a public company.

Secondly, after incorporation, the company has to register itself with the Reserve Bank of India, since a Micro Finance Institution (hereinafter referred to as MFI) is regulated by the Reserve Bank of India.

The list of documents to be filed with RBI for registration are given below:

1. Certified copies of Certificate of Incorporation.
2. Certified copies of extract of only the main object clause in the MOA relating to the financial business.
3. Board resolution stating that:
   - the company is not carrying on any NBFC activity/stopped NBFC activity and will not carry on/ commence the same before getting registration from RBI
   - the company has not accepted any public deposit, in the past (specify period)/does not hold any public deposit as on the date and will not accept the same in future without the prior approval of Reserve Bank of India
   - the UIBs in the group where the director holds substantial interest or otherwise has not accepted any public deposit in the past /does not hold any public deposit as on the date and will not accept the same in future
   - the company has formulated "Fair Practices Code" as per RBI Guidelines.

4. Copy of Fixed Deposit receipt & bankers certificate of no lien indicating balances in support of NOF.
5. For companies already in existence, the Audited balance sheet and Profit & Loss account along with directors & auditors report or for the entire period the company is in existence, or for last three years, whichever is less, should be submitted.
6. Copy of the certificate of highest educational and professional qualification in respect of all the directors.
7. Copy of experience certificate, if any, in the Financial Services Sector (including Banking Sector) in respect of all the directors.
8. Banker's report in respect of applicant company, its group/subsidiary/associate/holding company/ related parties, directors of the applicant company having substantial interest in other companies. The Banker's report should be about the dealings of these entities with these bankers as a depositing entity or a borrowing entity.

   Note: Please provide bankers report from all the bankers of each of these entities and provide the report for all the entities. The details of deposits and loans balances as on the date of application and the conduct of the account should be specified.

In addition to the documents required for registration as Type II-NBFC-ND, following list of documents / information to be submitted by the NBFC-MFI applicant:

i. Board resolution stating that:
   a) the company will be a member of all the Credit Information Companies and will be a member of at least one Self-Regulatory Organisation
   b) the company will adhere to the regulations regarding pricing of credit, Fair Practices in lending and non-coercive method of recovery as per RBI Guidelines
   c) the company has fixed internal exposure limits to avoid any undesirable concentration in specific geographical locations
   d) the company is not licensed under Section 25 of the Companies Act, 1956 / Section 8 of the Companies Act, 2013.

ii. Roadmap for achieving 85% qualifying assets.

In the developmental paradigm, microfinance has evolved as a need-based policy program to cater to the so far neglected target groups (women, poor, rural, deprived, etc.). Its evolution is based on the concern of all developing countries for empowerment of the poor and the alleviation of poverty. Microfinance programmes in the recent past have become one of the more promising ways to use scarce development funds to achieve the objectives of poverty alleviation.

## NIDHI

Nidhi Companies have been in existence since centuries. They existed even prior to the existence of the Companies Act, 1956.

A Nidhi Company, is one that belongs to the non-banking finance sector and is recognized under section 406 of the Companies Act, 2013.Their core business is borrowing and lending money between their members. They are also known as Permanent Fund, Benefit Funds, Mutual Benefit Funds and Mutual Benefit Company. They are regulated by the Ministry of Corporate Affairs, Government of India and are registered under the Companies Act, 2013(or any earlier enactments). Nidhis are more popular in South India and are highly localized single

office institutions. They are mutual benefit societies, because their dealings are restricted only to the members; and membership is limited to individuals. The principal source of funds is the contribution from the members. The loans are given to the members at relatively reasonable rates for purposes such as house construction or repairs and are generally secured. The deposits mobilized by Nidhis are not much when compared to the organized banking sector.

Nidhi company is governed by Nidhi Rules, 2014. They are incorporated in the nature of Public Limited Company and hence, they have to comply with two set of norms, one of Public limited company as per Companies Act, 2013 and another is the Nidhi Rules, 2014. No RBI approval is necessary to register the company, as RBI has specifically exempted this category of NBFC in India to comply its core provisions such as registration with RBI etc. Even though Nidhis are regulated by the provisions of the Companies Act, 2013, they are exempted from certain provisions of the Act, as applicable to other companies, due to limiting their operations within members.

The Ministry of Corporate Affairs on 19th April, 2022 tightened compliance requirements governing Nidhi companies.

Accordingly, a public company set up as a Nidhi with share capital of Rs. 10 lakhs needs to first get itself declared as a Nidhi from the central government. This can be done by filing an application showing a minimum membership of 200 (only individual members) and net owned funds of Rs 20 lakhs within 120 days of its incorporation.

Also, the promoters and directors of the company would be required to meet the criteria of fit and proper person as laid down in the rules. In order to make sure that applications for certification as Nidhi companies are processed timely, the new rules introduce the concept of deemed approval i.e. if no decision on the application is conveyed to the company within 45 days of filing the application, approval would be deemed as granted.

## Characteristics of a Nidhi Company

The characteristics of a Nidhi Company may be summarised below:

(1) It is allowed to transact business only with its members and with nobody else. Hence, in case a person wishes to place deposit with a Nidhi or borrow money from a Nidhi, he must first become a member (shareholder) of the Nidhi by subscribing to 10 equity shares or shares equivalent to Rs. 100.
(2) After commencement of the Companies Act, 2013, no Nidhi shall issue preference shares.
(3) They are allowed to open branches subject to compliance with Rule 10 of the Nidhi Rules, 2014, but do not operate on a pan India basis.
(4) They are incorporated as public companies with a minimum paid up equity share capital of Rs. 10,00,000.
(5) Loans may be provided only to its members and should be fully secured.
(6) A director of a Nidhi shall be a member and shall hold office for a term upto 10 consecutive years on the Board of a Nidhi.
(7) Nidhi can declare dividend not exceeding 25% and any higher amount shall be specifically approved by the Regional Director.

(8) Nidhi shall adhere to the prudential norms for revenue recognition and classification of assets in respect of mortgage loans or jewel loans as provided in Rule 20 of the Nidhi Rules, 2014.

## General restrictions or prohibitions on Nidhis (Rule 6)

No Nidhi shall –

- carry on the business of chit fund, hire purchase finance, leasing finance, insurance or acquisition of securities issued by any body corporate;
- issue preference shares, debentures or any other debt instrument by any name or in any form whatsoever;
- open any current account with its members;
- acquire another company by purchase of securities or control the composition of the Board of Directors of any other company in any manner whatsoever or enter into any arrangement for the change of its management, unless it has passed a special resolution in its general meeting and also obtained the previous approval of the Regional Director having jurisdiction over such Nidhi;
- carry on any business other than the business of borrowing or lending in its own name. Nidhis which have adhered to all the provisions of these rules may provide locker facilities on rent to its members subject to the rental income from such facilities not exceeding twenty per cent of the gross income of the Nidhi at any point of time during a financial year;
- accept deposits from or lend to any person, other than its members;
- pledge any of the assets lodged by its members as security;
- take deposits from or lend money to any body corporate;
- enter into any partnership arrangement in its borrowing or lending activities;
- issue or cause to be issued any advertisement in any form for soliciting deposit;
- private circulation of the details of fixed deposit Schemes among the members of the Nidhi carrying the words "for private circulation to members only" shall not be considered to be an advertisement for soliciting deposits.
- pay any brokerage or incentive for mobilising deposits from members or for deployment of funds or for granting loans.

## Benefits of incorporating a Nidhi Company

1. A Nidhi mobilises small savings, mostly of the middle class and disburses loans to eligible borrowers. Owing to their small size and closeness to the customers, disbursement of loans is speedy. This is especially useful in case the borrower is in urgent needs of funds.
2. The repayment is guaranteed, as the loans are secured and due to peer pressure, borrowers ensure that loan is repaid on due dates.
3. Nidhis offer a higher rate of interest on deposits. This makes it an attractive investment opportunity for people, especially the senior citizens.
4. The Board of Directors of a Nidhi normally consists of senior persons who have experience in handling finances and who are well respected in social circles. This lends credibility to the institution and instills confidence in the minds of borrowers and depositors.

## Incorporation of a Nidhi Company

For incorporation, the normal procedure for incorporating a public company is required to be complied with, such as obtaining availability of name, filing of Memorandum and Articles of Association and other related documents. Care must be taken to see that the Objects Clause of the Memorandum should restrict itself to the object of cultivating the habit of thrift and savings amongst its members, receiving deposits from and lending to its members only for their mutual benefit and for other permitted purposes. The name of the company should end with the words "Nidhi Limited".

1. On and after commencement of Nidhi (Amendment) Rules, 2022, a public company desirous to be declared as a Nidhi shall apply, in Form NDH-4, within a period of one hundred twenty days of its incorporation for declaration as Nidhi, if it fulfils the following conditions, namely: -

   (I) it has not less than two hundred members; and

   (II) it has Net Owned Funds of twenty lakh rupees or more.

2. The company shall also attach, alongwith Form NDH-4, the declaration with regard to fulfilment of fit and proper person criteria, as per this sub-rule, by all the promoters and directors of the company.
3. For the purpose of determining as to whether any promoter or director is a 'fit and proper person', the following shall be taken into account, namely: -
   a. integrity, honesty, ethical behaviour, reputation, fairness and character of the person; and
   b. the person not incurring any of the following disqualifications, namely: -
      i. criminal complaint or information under section 154 of the Code of Criminal Procedure, 1973 (2 of 1974) has been filed by a person authorised by the Central Government against such person and which is pending;
      ii. charge sheet has been filed against such person by any enforcement agency in matters concerning economic offences which is pending;
      iii. an order of restraint, prohibition or debarment has been passed against such person by any regulatory authority or enforcement agency in any matter concerning company law, securities laws or financial markets which is in force;
      iv. an order of conviction has been passed against such person by a court for any offence involving moral turpitude;
      v. such person has been declared insolvent and not been discharged;
      vi. such person has been found to be of unsound mind by a court of competent jurisdiction and the finding is in force;
      vii. such person has been categorised as a willful defaulter;
      viii. such person has been declared a fugitive economic offender;
      ix. such person is a director in five or more companies incorporated or declared as Nidhi, or is a promoter of three or more companies incorporated or declared as Nidhi.

4. The Central Government, shall examine the application filed in Form NDH-4 and convey its decision within a period of forty five days to the company:

   Provided that in case a decision on an application filed in form NDH-4 is not taken by the Central Government within the aforesaid period of receipt of such application, the same shall be deemed as approved.

5. On being satisfied that the company meets the above requirements as set out under point (2) and (3), the Central Government, shall notify in the Official Gazette, declaring it as a Nidhi or Mutual Benefit Society, as the case may be:

   Provided that the decision of the Central Government approving the application, shall be filed by the company with the Registrar.

   Provided further that such company shall commence its business only once the decision of the Central Government approving its application is obtained from the Central Government pursuant to the declaration given under rule 12 of the Companies (Incorporation) Rules, 2014.

6. In case a company does not comply with the requirements of the criteria as set out in point (1), it shall not be allowed to file Form No. SH-7 (Notice to Registrar of any alteration of share capital) and Form PAS-3 (Return of allotment).
7. The above provisions as set out in Nidhi (Amendment) Rules, 2022 shall not be applicable to a public company incorporated under the Act before the date of commencement of the said Rule.

## PAYMENT BANKS

Payment banks is a new model of banks conceptualised by the Reserve Bank of India (RBI). These banks can accept a restricted deposit, which is currently limited to Rupees 1 lakh per customer and may be increased further. They can pay interest on these deposits just like savings bank account. Both current account and savings accounts can be operated by such banks. Payments banks can issue services like ATM cards, debit cards, net-banking, third party transfers and mobile-banking and offer remittance services. These banks cannot grant loans or issue credit cards.

On 7th April, 2021, in order to expand the ability of payments banks to cater to the growing needs of their customers, the current limit on maximum end of day balance of Rs.1 lakh per individual customer was increased to Rs.2 lakh.

A committee headed by Dr. Nachiket Mor recommended setting up of 'Payments Bank' to cater to the lower income groups and small businesses. There are two kinds of banking licences that are granted by the Reserve Bank of India - universal bank licence and differentiated bank licence.

Payments bank comes under a differentiated bank licence since it cannot offer all the services that a commercial bank offers. In particular, a payments bank cannot lend.

The main objective of payments bank is to widen the spread of payment and financial services to small business, low-income households, migrant labour workforce in secured technology-driven environment. With payments banks, RBI seeks to increase the penetration level of financial services to the remote areas of the country.

To open a bank account and the application process of payments bank is made very easy as compared to other banks. These bank accounts can be opened instantly through their respective mobile apps just by providing details like Aadhar number with KYC verification.

Most of the payment banks have a non-NBFC heritage and will use payment bank as a customer retention and acquisition mechanism.

## Regulations

Payment Banks are regulated by the Reserve Bank of India. It released Guidelines for Licensing of Payment Banks on November 27, 2014 and Operating Guidelines for Payment Banks on October 6, 2016.

An application has to be filed with Reserve Bank of India in Form III under Section 22 of the Banking Regulation Act, 1949 for a licence to commence banking business by a company incorporated in India and desiring to commence banking business.

In July 2014, the RBI released the draft guidelines for payment banks, seeking comments from interested entities and public at large. After taking in to account suggestions from respondents in November 2014, RBI released the final guidelines for payment banks and invited applications for opening such banks from interested parties, subject to the guidelines enunciated. There were 41 applications from various applicants including some corporate houses. After a due process of vetting these applications through an External Advisory Committee headed by Mr. Nachiket Mor, in August 2015, the RBI accorded 'in-principle' licences to the following eleven entities to launch payments banks within a period of 18 months.

1. Aditya Birla Nuvo Limited
2. Airtel M Commerce Services Limited
3. Cholamandalam Distribution Services Limited
4. India Post Limited
5. FinoPayTech Limited
6. National Securities Depository Limited
7. Reliance Industries Limited
8. Vodafone M-Pesa Limited
9. Paytm Limited
10. Tech Mahindra Limited
11. Sun Pharmaceuticals Limited.

Within this period of 18 months, these entities were to comply with requirements regarding capital funds of Rs. 100 crores. The "in-principle" license was valid for 18 months within which the entities must fulfill the requirements and they were not allowed to engage in banking activities within the period. The RBI will grant full licenses under Section 22 of the Banking Regulation Act, 1949 after it is satisfied that requirements/conditions have been fulfilled.

The other terms and conditions are as follows:

- To be registered as a public limited company under the Companies Act, 2013.
- Payment Banks cannot form subsidiaries.
- For the first five years, the promoters stake to remain at 40% at minimum.
- Foreign shareholding will be allowed in these banks as per extant FDI norms.

- The voting rights will be regulated as per provisions of The Banking Regulation Act 1949. [Voting rights are restricted at 10% for any one share holder. RBI has the discretion to raise this to 26% on merits.].
- If there is any acquisition of more than 5% shares this will require prior RBI approval.
- The majority of the bank's board of directors should consist of independent directors, appointed according to RBI guidelines.
- The bank should be fully networked from the beginning. l Initially, the deposits will be capped at Rs. 1,00,000 per customer, but later it may be raised on the basis of performance of the bank.
- No lending activity is permitted. Bank can accept utility bills.
- A quarter of its branches should be in unbanked rural areas.

The list of Payment Banks operating in India are –

1. Airtel Payments Bank Ltd.
2. India Post Payments Bank Ltd.
3. FINO Payments Bank Ltd.
4. Paytm Payments Bank Ltd.
5. Jio Payments Bank Ltd.
6. NSDL Payments Bank Ltd.

Payment Banks can be promoted by:

i. Existing non-bank Pre-paid Payment Instrument (PPI) issuers;
ii. Individuals/professionals;
iii. NBFCs, Corporate Business Correspondents(BCs);
iv. Mobile telephone companies;
v. Super-market chain;
vi. Companies;
vii. Real sector cooperatives; that are owned and controlled by residents; and
viii. Public sector entities.

A promoter/promoter group can have a joint venture with an existing scheduled commercial bank to set up a payments bank. Scheduled commercial banks can take equity stake as permitted under Section 19 (2) of the Banking Regulation Act, 1949. Promoter/promoter groups should be 'fit and proper' with a sound track record of professional experience or running their businesses for at least a period of five years in order to be eligible to promote payments banks. PBs can accept demand deposits and they will initially be restricted to hold a maximum balance of Rs. 100,000 per individual customer.

PBs are also permitted to issue ATM/debit cards (but cannot issue credit cards); offer Payments and remittance services through various channels; function as Business Correspondent of another bank as per RBI guidelines; distribute non-risk sharing products like mutual fund units and insurance products, etc.

PBs cannot undertake lending activities. Apart from maintaining CRR with the RBI, a PB is required to invest minimum 75% of its "demand deposit balances" in SLR securities with maturity up to one year and hold maximum 25% in current and time/fixed deposits with other Scheduled Commercial banks for operational and liquidity management.

Right from the beginning a PB should be "fully networked and technology driven" as per the standards generally accepted and norms. Should also have a high powered Customer Grievances Cell to handle customer complaints. Procedure for granting license and its validity is similar to that of SFBs.

Key issues which require compliance by an applicant company are summarised below:

1. The minimum capital requirement is Rupees 100 crore. For the first five years, the stake of the promoter should remain at least 40%.
2. Foreign shareholding will be allowed in these banks as per the rules for FDI in private banks in India.
3. The voting rights will be regulated by the Banking Regulation Act, 1949. The voting right of any shareholder is capped at 10%, which can be raised to 26% by Reserve Bank of India. Any acquisition of more than 5% will require approval of the RBI.
4. The majority of the bank's board of directors should consist of independent directors, appointed according to RBI guidelines.
5. The bank should be fully networked from the beginning. The bank can accept utility bills. It cannot form subsidiaries to undertake non-banking activities.
6. Initially, the deposits will be capped at Rs. 100,000 per customer, but it may be raised by the RBI based on the performance of the bank.
7. The bank cannot undertake lending activities. 25% of its branches must be in the unbanked rural area.
8. The bank must use the term "payments bank" in its name to differentiate it from other types of bank.
9. The banks will be licensed as payments banks under Section 22 of the Banking Regulation Act, 1949.
10. It will be registered as public limited company under the Companies Act, 2013.

## MUDRA BANKS

Micro Units Development and Refinance Agency Bank (or MUDRA Bank) is a public sector financial institution in India. It provides loans at low rates to micro-finance institutions and non-banking financial institutions which then provide credit to MSMEs. It was launched by Prime Minister Narendra Modi on 8 April 2015. MUDRA provides refinance support to Banks / Micro Finance Institutions (MFIs) for lending to micro units having loan requirement up to Rs. 10 lakh.

MUDRA provides refinance to micro business under the Scheme of Pradhan Mantri MUDRA Yojana. The other products are for development support to the sector. It targets mainstream young, educated or skilled workers and entrepreneurs who cannot have access to credit from regular banking system.

It will provide its services to small entrepreneurs outside the service area of regular banks, by using last mile agents. About 5.77crore (57.6million) small business have been identified as target clients using the NSSO survey of 2013. Only 4% of these businesses get finance from regular banks. The bank will also ensure that its clients do not fall into indebtedness and will lend responsibly.

The bank will classify its clients into three categories and the maximum allowed loan sums will be based on the category:

Shishu: Allowed loans up to Rs. 50,000 (US$780)

Kishore: Allowed loans up to Rs. 5 lakh (US$7,800)

Tarun: Allowed loans up to Rs. 10 lakh (US$16,000)

Those eligible to borrow from MUDRA bank are:

- Small manufacturing unit
- Shopkeepers
- Fruit and vegetable vendors
- Artisans.

The basic criteria of age should be 18 years old. Loan under the scheme of the Pradhan Mantri Mudra Bank Loan will be available if and only if it is for commercial and business purposes and not for personal purposes. At the most, borrower can buy vehicle from mudra loan, given that it is used for commercial purposes. Lastly, this loan is for new business and is only applicable for small business owners.

## Procedure for loan

Once the beneficiary identifies an idea and comes up with a business plan, he is supposed to select the business category under which he wishes to avail the loan (Shishu, Kishor or Tarun).

The beneficiary can contact the nearest Public/ Private sector bank where he/ she can apply for business under PMMY. The list of institutions partnering in the MUDRA initiative is available on the MUDRA portal.

An application form under this scheme will be available with each of the above listed institutions. This application form has to be submitted along with the following documents for the approval of the loan:

- Proof of Identity (Self attested Voter ID/Driving License/PAN Card/ Aadhaar Card/Passport/any other Photo ID issued by Government)
- Proof of Residence (Recent Telephone Bill/Electricity Bill/Property Tax Receipt (not older than 2 months)/Voter ID Card/Aadhaar Card/Passport/Domicile Certificate/Certificate Issued by a local authority)
- Applicant's recent photograph (not older than 6 months)
- Quotation of Machinery/other items to be purchases
- Name of the Supplier/Details of Machinery/Price of Machinery
- Proof of Identity/Address of the Business Enterprise (relevant licenses & certificates)
- Proof of Category (SC/ST/OBC/Minority etc.)

Apart from the above-mentioned documents, individual banks could ask for other documents as needed.

The Banks are not supposed to take any processing fee and are not supposed to ask for any collateral. The repayment period is also extended to 5 years. But it is also made clear that the applicant should not be a defaulter to any Bank or financial institution.

MUDRA Bank is not a separate bank (like SBI etc). It is a government financing scheme to provide business loan to new small businesses in India. To get business loan under PPMY the candidate has to contact the nearest Public/ Private sector bank. MUDRA will be operating as a refinancing institution through State / Regional level intermediaries.

MUDRA's delivery channel is conceived to be through the route of refinance primarily to NBFCs / MFIs, besides other intermediaries including Banks, Primary Lending Institutions etc. The rate of interest will be fixed by the institutions time to time based on guidelines from the RBI.

Mudra loan is extended for a variety of purposes which result in income generation and employment creation. The loans are extended mainly for:

- Business loan for Vendors, Traders, Shopkeepers and other Service Sector activities
- Working capital loan through MUDRA Cards
- Equipment Finance for Micro Units
- Transport Vehicle loans – for commercial use only
- Loans for agri-allied non-farm income generating activities, e.g. pisciculture. bee keeping, poultry farming, etc.
- Tractors, tillers as well as two wheelers used for commercial purposes only.

Following is an illustrative list of the activities that can be covered under MUDRA loans:

**(1) Transport Vehicle**

Purchase of transport vehicles for transportation of goods and passengers such as auto rickshaws, small goods transport vehicles, 3 wheelers, e-rickshaws, taxis, etc. Tractors/Tractor Trolleys/Power Tillers used only for commercial purposes are also eligible for assistance under PMMY. Two Wheelers used for commercial purposes are also eligible for coverage under PMMY.

**(2) Community, Social & Personal Service Activities**

Salons, beauty parlours, gymnasium, boutiques, tailoring shops, dry cleaning, cycle and motorcycle repair shops, DTP and Photocopying Facilities, Medicine Shops, Courier Agents, etc.

**(3) Food Products Sector**

Activities such as papad making, achaar making, jam/jelly making, agricultural produce preservation at rural level, sweet shops, small service food stalls and day to day catering / canteen services, cold chain vehicles, cold storages, ice making units, ice cream making units, biscuit, bread and bun making, etc.

**(4) Textile Products Sector / Activity**

Handloom, powerloom, khadi activity, chikan work, zari and zardozi work, traditional embroidery and hand work, traditional dyeing and printing, apparel design, knitting, cotton ginning, computerized embroidery, stitching and other textile non garment products such as bags, vehicle accessories, furnishing accessories, etc.

**(5) Business loans for Traders and Shopkeepers**

Financial support for on lending to individuals for running their shops / trading & business activities / service enterprises and non-farm income generating activities with beneficiary loan size of up to 10 lakh per enterprise / borrower.

**(6) Equipment Finance Scheme for Micro Units**

Setting up micro enterprises by purchasing necessary machinery / equipments with per beneficiary loan size of upto 10 lakh.

**(7) Activities allied to agriculture**

'Activities allied to agriculture', e.g. pisciculture, bee keeping, poultry, livestock-rearing, grading, sorting, aggregation agro industries, diary, fishery, agri-clinics and agribusiness centres, food & agro-processing, etc. (excluding crop loans, land improvement such as canal, irrigation and wells) and services supporting these, which promote livelihood or are income generating shall be eligible for coverage under PMMY in 2016-17.

## MUDRA Card

MUDRA Card is a debit card issued against the MUDRA loan account, for working capital portion of the loan. The borrower can make use of MUDRA Card in multiple drawals and credits, so as to manage the working capital limit in cost-efficient manner and keep the interest burden minimum. MUDRA Card also helps in digitalization of MUDRA transactions and creating credit history for the borrower. MUDRA Card can be operated across the country for withdrawal of cash from any ATM / micro ATM and also make payment through any 'Point of Sale' machines.

## Types of funding support from MUDRA

1. **Micro Credit Scheme (MCS) for loans up to 1 lakh finance through MFIs.**

   It is offered mainly through Micro Finance Institutions (MFIs), which deliver the credit up to Rs.1 lakh, for various micro enterprise activities. Although, the mode of delivery may be through groups like SHGs/JLGs, the loans are given to the individuals for specific income generating micro enterprise activity. The MFIs for availing financial support need to enroll with MUDRA by complying to some of the requirements as notified by MUDRA, from time to time.

2. **Refinance Scheme for Commercial Banks / Regional Rural Banks (RRBs) / Scheduled Co-operative Banks.**

   Different banks like Commercial Banks, Regional Rural Banks and Scheduled Cooperative Banks are eligible to avail of refinance support from MUDRA for financing micro enterprise activities. The refinance is available for term loan and working capital loans, up to an amount of 10 lakh per unit. The eligible banks, who have enrolled with MUDRA by complying to the requirements as notified, can avail of refinance from MUDRA for the loan issued under Shishu, Kishor and Tarun categories.

3. **Women Enterprise programme.**

   To encourage women entrepreneurs, the financing banks / MFIs may consider extending additional facilities, including interest reduction on their loan. At present, MUDRA extends a reduction of 25bps in its interest rates to MFIs / NBFCs, who are providing loans to women entrepreneurs.

4. **Securitization of loan portfolio.**

   MUDRA also supports Banks / NBFCs / MFIs for raising funds for financing micro enterprises by participating in securitization of their loan assets against micro enterprise portfolio, by providing second loss default guarantee, for credit enhancement and participating in investment of Pass Through Certificate (PTCs) either as Senior or Junior investor. PTC is a certificate that is given to an investor against certain mortgaged backed securities that lie with the issuer.

## CHIT FUNDS

Section 2(B) of Chit Fund Act 1982 defines it as a rotating savings and credit association system, a popular practice in India. Chit fund schemes may be organized by financial institutions and unorganized money market industries or informally among friends, relatives, or neighbors. In some variations of chit funds, the savings are for a specific purpose. It's mostly popular in the areas where people have limited access to banking facilities therefore they prefer to invest their money in a Chit fund.

In a chit fund, a specific number of investors invest their money with a promise that their investment will be multiplied within a short span of time with surety and guaranteed return. Under this type of saving arrangement, a specific number of subscribers contribute payments in installment over a defined period of time.

A chit fund works in such a manner which comprises a group of members, called subscribers. An organizer, a company or a trusted relative or neighbor, brings the group together and administers the activities of the group. For their efforts, the organizer is either compensated each month or at withdrawal time. The fee may be omitted in informal situations.

### Features of Chit Funds

1. They have a predetermined value and duration.
2. They work like microfinance institutions.
3. They combine both, credits and savings in a single scheme.
4. They cater to the financial needs of low income households.
5. They allow the deposits made by the contributors to be turned into a lump sum. This is done by three mechanisms.
6. Safe Deposits: A person can deposit the money in the present and enjoy the lump sum in future.
7. Loans: A person can take a loan in the preset and continue to make payments in the future.
8. Insurance: Allows the depositor to enjoy the lump sum in case of an emergency.
9. They offer loan at a lower interest rate than moneylenders.

### Relevant Statute Governing Chit Funds

Chit funds companies in India are governed by various State or Central laws. Organized chit fund schemes are required to be registered with the Registrar of Firms, Societies, and Chits. The chit funds are governed according to the following laws:

1. Union Government – Chit Funds Act, 1982 (Except the State of Jammu and Kashmir)
2. Tamil Nadu Chit Funds Act, 1961
3. The Chit Funds (Karnataka) Rules, 1983

4. Delhi Chit Funds Rules, 2007
5. Maharashtra Chit Fund Act, 1975
6. West Bengal Protection of Interest of Depositors in Financial Establishments Bill, 2013
7. Prize Chits and Money Circulation Schemes (Banning) Act, 1978.

The Reserve Bank of India (RBI) is the regulator of banks and other non-banking financial companies, but it does not control the chit fund business. Despite the fact that chit funds are accepting deposits, the term 'deposit' as defined by the Reserve Bank of India Act, 1934 does not comprise the subscription to chits. However, the RBI can always guide State Governments on the regulatory aspects of the creation of rules or exemption of certain chit funds. The latest guidelines provided by the RBI regarding the Chit are given in RBI/2014-15/636.

Although, SEBI as the regulator and controller of the securities market regulates and manages collective investment schemes. But the SEBI Act, 1992 specifically precludes chit funds from their definition of collective investment schemes

Prevention of Money Laundering (Amendment) Act, 2012 has recognized Chit Funds in Section 2(l).

Under Prize Chits and Money Circulation Scheme (Banning) Act, 1978 (PCMCS) 'Conventional Chit' i.e. the chit mentioned above has been defined in Section 2(a). In this act, another type of chit has also been defined under Section 2(e) named as 'Prize Chit' and it is banned in the territory of India. Prize chit is different from conventional chit as prize chit involves the sale of certificates, units, and other instruments and there is an admission fee also, whereas, conventional chit does not contain any of those features.

## Chit Funds Act, 1982

Important definitions in the Act

- Chit Agreement: It is defined as a document which contains the articles of agreement between the foreman and the subscribers of the chit.
- Chit Amount: It is the sum-total of all the subscriptions payable by all the subscribers for any instalment of a chit without any deduction of discount.
- Discount: It is the sum of money which a prized subscriber is, under the terms of the chit agreement, required to forego and which is set apart under the said agreement to meet the expenses of running the chit or for distribution among the subscribers or for both.
- Foreman: The person who under the chit agreement is responsible for the conduct of the chit and includes any person discharging the functions of the foreman under section 39 of the Act.

### Key points of the Act

1. The Act states that all registered chit funds should contain either of the words "chit fund", "chitty", or "Kuri" as part of their name. These names can only be used by chit funds, no other person or entity has the right to use these names.
2. Registered chit funds are not allowed to conduct any business other than chit businesses.

3. The foreman is allowed to start or run several chits simultaneously. However, prior approval of the state government is required before starting each chitty.
4. It prohibits every kind of fund that does not have prior permission of the respective state government.
5. The foreman needs to deposit 100% of the chit value with the Registrar of Chits prior to the commencement of the chit scheme. This deposit will be refunded to the foreman on the successful completion of the chit cycle.
6. All Chit funds registered under this Act needs to have its accounts audited by a qualified Chartered Accountant.
7. The Act requires that all registered chit funds impose a 40% cap on the bidding amount. This 40% is calculated on the chit value of the scheme. This bid-cap is administered to ensure that the bid does not rise uncontrollably leading to subsequent default by the bidder.

## Types of Chit Funds

Chit funds are of different kinds. These are:

1. **Organized Chit Funds:** In northern India, a common type of chit fund is where small paper chits with each member's names are gathered in a box. When all the members come together for a monthly gathering, the person who is in charge in front of all the present members picks a chit from the box. The member so selected gets to take home the day's collection. Afterwards, that person's chit is removed from the box. The person who was previously selected comes to the meetings and pays his/her share, but his/her name will not be selected again.
2. **Special Purpose Funds:** Some chit funds are organized for a specific purpose. For example, Christmas gifts fund which has a very specific end date which is about a week before Christmas. Such a fund can reduce the cost and relieves the members from extra work in the busy festival season. Nowadays, such special purpose chit funds are conducted by, ladies wear shops, jewellers etc. to promote their goods.
3. **Online Chit Funds:** With the popularity of e-commerce, Chit funds are being organized online as well. Online chit funds are conducted online, and contributors can make their monthly contributions and receive the prize through online transactions including electronic funds transfer system. Each member gets his or her own online account to manage and circulate chit funds.
4. **Registered Chit Funds:** Registered chit funds are those funds which are registered with the state government under the Chit Funds Act,1982. There are over 10,000 registered chit funds in India.
5. **Unregistered Chit Funds:** Unregistered funds are those which are not registered with any state government. They are not regulated under any law.

## Registration of Chit Funds

The Chit Fund Act, 1982 regulates the Chit Fund business in India. According to the Act, a "chit" means a transaction whether it is called chit, chit fund, chitty, kuri or by any other name by or under which a person enters into an agreement with a specified number of individual that every one of them will subscribe to a certain sum of money (or instead a certain quantity of grain) by way of periodical instalments over a definite time period and that each

such subscriber will, in her/his turn, as determined by lot or by auction or by tender or in such other manner as may be specified in chit agreement, be entitled to prize amount.

A transaction cannot be called as a chit unless the members will not subscribe and pay for it to be entitled for the prize money. If some alone, but not all, of subscribers get the prize amount without any liability to pay the future subscriptions or all the subscribers get the chit amount by turns with a liability to pay future subscriptions, it can't be a chit fund.

Though the chit fund companies are the type of a Non-Banking Financial Companies (NBFC), they are exempted from being registered with the Reserve Bank of India. The chit funds are a category of NBFC which are regulated by the other regulators and hence exempt from the requirement of registration under RBI Act.

To start this business in India, it is recommended that the promoters of the chit fund company should first incorporate a Private Limited Company with the objective of operating a chit fund business. Once a private limited company is constituted, the company then applies with the appropriate Chit Fund Registrar of the State to obtain the registration for operating a Chit fund company. A chit fund business can only be started after obtaining the chit fund business registration from the relevant Registrar of the State.

The registration will not be given to:

1. Any individual or entity convicted of any offence under the Chit Fund Act or under any other Act regulating the business and sentenced to imprisonment for any such offence; or
2. Any individual or entity who had defaulted in payment of the fees or the filing of any statement or the record required to be paid or filed under this Act or had previously violated any of the provisions of this Act or the rules made thereunder; or
3. Any individual or entity had been convicted of any offence that involves moral turpitude and had been sentenced to imprisonment for any such offence unless a period of five years has elapsed since his/her release.

## Restrictions imposed by RBI on chit fund business

- Chit fund business can be conducted only by a registered company. Running of Chit business by family and partnership firms are restricted.
- Chit companies must register with the Registrar of Chit Company in every state, furnishing full particulars about their chit company.
- The maximum discount that could be taken in a bid was restricted to 30% of the total chit amount. However, in 2001, the same has been enhanced to 40% (in the case of a chit for Rs. 1 lakh, not more than Rs. 40,000/- can be the bid amount).
- Details of each and every chit must be furnished to Reserve Bank of India along with the personal particulars of the subscribers.
- It is mandatory to keep one month's chit amount of all the subscribers/members with the Reserve Bank of India till the end of a particular chit.

# Chapter 9 : Business Collaborations

## BUSINESS COLLABORATION

Collaboration is when two or more entities work together through idea sharing and thinking to accomplish a common goal is known as Collaboration. Collaboration provides solutions, give a strong sense of purpose and also reinforce the objectives of coming together.

### Types of Business Collaboration

**Horizontal Collaboration:** When the businesses in the same set of functional area agree to collaborate in a way to improve their competencies is known as Horizontal Collaboration. For example: conducting research toward new or improved products and services requires monetary investment, time, and worker capacity.

**Vertical Collaboration:** Vertical Collaboration is a collaboration wherein the business collaborates with companies in its supply chain either upward and/or downwards (its suppliers and/or distributors). Vertical collaboration often allows businesses to minimize risk in the supply chain and obtain lower prices in exchange for long-term commitment. For example: Computers shipping with pre-installed third-party software, discounted airport transfers offered by airlines etc.

**Intersectional Collaboration:** When the Businesses from different functional areas agree to share their special knowledge for the advancement of all partners in collaboration is known as Intersectional Collaboration. For example: Manufacturing and Marketing collaborations, Referral rewards, tie-ups.

**Joint Venture:** Two or more businesses form a new company. The new company is its own legal entity, and its profits are split according to terms spelled out in a formal contract is a Joint Venture. For example: One party in the joint venture provides technical support and another party provides manufacturing and marketing arrangements in joint venture.

**Equity:** A company acquires a minor equity stake in another business in exchange for a monetary investment. Such exchanges can accompany other types of collaboration and, to a certain extent, agreed-upon access to decision making. For example: Funding to start-ups on equity basis, equity partnership in technical know-how.

## FOREIGN COLLABORATION

- Foreign collaboration is an alliance incorporated to carry on the agreed task collectively with the participation (role) of resident and non-resident entities. Foreign collaboration is an alliance of domestic (native) and foreign (non-native) entities like individuals, firms, companies, organizations, governments, etc., that come together with an intention to finalize a contract on some tasks or jobs or projects.
- Foreign collaboration is an alliance (a union or an association) formed for mutual benefit of collaborating parties.
- Foreign collaboration is a mutual co-operation between one or more resident and non-resident entities. In other words, for example, an alliance (a union or an association) between a foreign based company and a domestic company forms a foreign collaboration.

It is a strategic alliance between one or more resident and non-resident entities. Only two or more resident (native) entities cannot make a foreign collaboration possible. For its formation and as per above definitions, it is mandatory that one or more non-resident (foreign) entities must always collaborate with one or more resident (domestic) entities.

- Before starting a foreign collaboration, both entities, for example, a resident and non-resident company must always seek approval (permission) from the Governmental Authority of the domestic country.
- During an ongoing process of seeking permission, the collaborating entities prepare a preliminary agreement.
- According to this preliminary agreement, for example, the non-resident company agrees to provide finance, technology, machinery, know-how, management consultancy, technical experts, and so on. On the other hand, resident company promises to supply cheap labour, low-cost and quality raw-materials, sufficient land for setting factories, etc.
- After obtaining the necessary permission, individual representative of a resident and non-resident entity signs this preliminary agreement. Signing the agreement acts as a written acceptance to each other's expectations, terms and conditions. After acceptance, a contract is executed, and foreign collaboration gets established. Contract is a legally enforceable agreement.
- After establishing foreign collaboration, resident and non-resident entity start business together in the domestic country.
- Collaborating entities share their profits as per the profit-sharing ratio mentioned in their executed contract.
- The tenure (term) of the foreign collaboration is specified in the written contract.

## Examples of Foreign Collaboration

Some prominent examples of foreign collaboration between an Indian and Foreign entity are depicted below.

ICICI Lombard GIC (General Insurance Company) Limited is a financial foreign collaboration between ICICI Bank Ltd., India and Fairfax Financial Holdings Ltd., Canada.

ING Vysya Bank Ltd. is a financial foreign collaboration formed between ING Group from Netherlands and Vysya Bank from India.

Tata DOCOMO is a technical foreign collaboration between Tata Teleservices from India and NTT Docomo, Inc. from Japan.

Sikkim Manipal University (SMU) from India runs some academic programs through an educational foreign collaboration with abroad universities like Liverpool School of Tropical Medicine from UK, Loma Linda and Louisiana State Universities from USA, Kuopio University from Finland, and University of Adelaide from Australia.

## Features of Foreign Collaboration

1. **Type of partnership:** Foreign collaboration is a type of partnership between a domestic entity and foreign based entity. In such an alliance, each partner plays some crucial role. Foreign entity generally provides support for finance, technology, engineering, management, etc. On the other hand, a domestic based entity provides cheap labour, high-

quality raw materials, land and so on. Here, domestic and foreign entity share their profits as per profit-sharing ratio mentioned in their contract.

2. **Requires an Approval of the government:** Before initiating foreign collaboration, collaborating entities (domestic and foreign) must seek permission from the government of the domestic country. The government gives approval only when the contract of foreign collaboration is prepared in accordance with the industrial or foreign policy of its country.
3. **Entities are from developed and developing country:** In foreign collaboration, one or more abroad entities are generally from developed countries like U.S.A., Germany, Japan, etc. Whereas, a domestic entity is from a developing country or less-developed country (LDC). Some examples of developing countries are India, Sri-Lanka, Indonesia, and so on.
4. **Benefits to developed country:** The benefits of foreign collaboration to a developed country are as follows:
   - Foreign collaboration helps a developed country earn good returns on its overall investments made in a domestic country
   - It also aids a developed country earn a good reputation for providing financial and technical assistance (support) to the developing country.
5. **Benefits to developing country:** The benefits of foreign collaboration to a developing country are as follows:
   - Foreign collaboration helps a developing country to get finance, technology, machinery, knowhow, management and technical expertise, etc. from a developed country.
   - It also assists a developing country to achieve a faster economic growth.
6. **Establishes business relationships:** Foreign collaboration establishes business (trade) relationships among different countries. It removes their economic gaps (hurdles) and brings them closer to each other.
7. **Initiation of foreign collaboration:** A foreign collaboration is initiated at the government and/or corporate level. At governmental level foreign collaboration, a government of some foreign country collaborates with the government of a domestic country. Similarly, at corporate level foreign collaboration, a company from some foreign country collaborates with the company from a domestic country. These companies may be either private or public in nature.
8. **Better utilization of resources:** Though developed countries are good with finance, technology, management and technical expertise, generally, they face difficulties to meet a continuous supply of low-cost labour and quality raw materials. On the other hand, generally, a developing country has more availability of low-cost labour and plenty of quality raw materials. Foreign collaboration brings developed and developing country together and helps them to satisfy each other's needs by exchanging their excess resources. Finally, this leads to a better utilization of available resources.
9. **Scope of foreign collaboration:** The scope of foreign collaboration is very wide. It covers core business activities such as: Finance, Production, Management and Technical consultancy, Advertising and Marketing, etc.

10. **Miscellaneous features:** Miscellaneous features of foreign collaboration are listed as follows:
    - Foreign collaboration reduces unemployment in a developing country.
    - It improves infrastructure in a developing country.
    - It helps to increase revenue of the governments in the form of taxes and duties.
    - It also aids to achieve economic growth in developed and developing country

## Objectives of Foreign Collaboration

The main intention/ prime goal or objective of foreign collaboration is to:

- Improve the financial growth of the collaborating entities.
- Occupy a major market share for the collaborating entities.
- Reduce the higher operating cost of a non-resident entity.
- Make an optimum and effective use of resources available in the resident entity's country.
- Generate employment in the resident entity's country.

## Types of Foreign Collaboration

1. **Financial collaboration:** In case of financial collaboration, the inflow of foreign investment takes place in the domestic (host) country. In this method, the foreign company lends finance by:
    - **Purchasing ownership shares:** Here, foreign company purchases ownership shares of the domestic company and in return gets the dividend for these shares.
    - **Giving long-term loans:** Here, foreign company gives long-term loans to the domestic company and in return gets interest from these loans.
    - **Giving credit facility:** Here, foreign company gives credit facility to the domestic (native) company. The native company uses this credit facility to purchase raw-materials, plant and machinery.

    Thus, in financial collaboration, there is an inflow of finance from developed countries to developing countries.

2. **Technical collaboration:** In case of technical collaboration, the inflow of foreign technology takes place in the domestic (host) country. Technical collaboration includes integration of foreign technology with domestic (indigenous) technology. In technical collaboration, the foreign company provides technological know-how, professional services and expertise, installs automated machineries, etc., in the domestic country. Here, an inflow of modern technology takes place from the developed country to the developing country. Technical collaboration helps to remove an existing technological gap. Therefore, the governments of developing countries encourage such collaborations. In developing countries, most of the foreign collaborations are technical in nature.
3. **Marketing collaboration:** In case of marketing collaboration, the inflow of foreign goods and services take place in the domestic (host) country. In marketing collaboration integration of domestic and foreign market takes place. In marketing collaboration, foreign company agrees to sell goods produced by the domestic company. The foreign company sells these goods in its own country and/or in the international market. It uses

its distribution network to sell the goods. From the viewpoint of a developing country, marketing collaboration is very beneficial for increasing its exports of goods and services.

4. **Management consultancy collaboration:** In case of management consultancy collaboration, the inflow of foreign management consultancy takes place in the domestic (host) country. In management consultancy collaboration integration of domestic and foreign consultancy takes place. In management consultancy collaboration, foreign company provides management skills to the domestic company and teaches it everything about management. In other words, it gives advice and solves management problems of the domestic company. It teaches management skills for the following:
   - Production management.
   - Marketing management.
   - Personnel management.
   - Financial management.

   The foreign company also helps the domestic company to modernize and diversify its business process. So, in management consultancy collaboration, the foreign company increases the management efficiency of the domestic company. This type of collaboration is found in both private and public sector.

## Foreign Collaboration in India

In India there are basically two forms of foreign collaboration. The collaboration may be either financial collaboration or it may be technical. In case of financial collaboration the approving authority is the Reserve Bank of India and in the case of technical collaboration the approving authority is Department for Promotion of Industry and Internal Trade (DPIIT) in the Ministry of Commerce and Industry, Government of India.

The approach of the Government has been roughly the same since the year 1949 that is to allow foreign direct investment on preferential basis in sectors that will be beneficial for the country. The foreign or Indian undertakings will have to conform to the Industrial policy of the country. Foreign investors are in all cases considered equal to their Indian partners. The Government has enforced The Foreign Exchange Management Act 1999 (FEMA) which seeks to regulate foreign exchange.

A breach of the provisions of the old act resulted in a criminal offence with the burden of proof lying on the guilty. However the new Act provides for only a civil remedy and for an offence the accused cannot be arrested unless he defaults in payment of penalty for contravention.

For setting up a foreign collaboration, approval from the government under the relevant foreign exchange laws in force and the requisite Government policy is required.

Under the Act now a foreign collaboration may be formed by a foreign company without the necessity of forming a company with an Indian counterpart. Any foreign collaboration which exceeds the minimum limited set out in the automatic route requires approval from the government.

The Government has set up a Foreign Investment Promotion board to encourage foreign investment in India. Some of the functions of the Board include:

- speed up clearance of proposals
- to review the collaborations cleared
- ear-marking and ascertaining of contacts to invest in India

## JOINT VENTURE

A simple dictionary meaning of the word 'Joint Venture' is a commercial enterprise undertaken jointly by two or more parties which otherwise retain their distinct identities.

It is an entity formed between two or more parties to undertake economic activity together. The parties agree to create a new entity to share in the revenues, expenses, and control of the enterprise. Joint Ventures are generally created for a single activity or project, and may have a limited time span. The use of a separate entity allows the parties to limit the liabilities associated with the relationship.

In India till recently, almost all equity-based ventures were structured in the form of a company. However, with the government permitting foreign investment in Limited Liability Partnership (LLP) Firms, there is significant interest in LLP firms

### Definition

Alternatively, we can define a joint venture is an association of two or more individuals or business entities who combine and pool their respective expertise, financial resources, skills, experience, and knowledge in the furtherance of a particular project or undertaking. As per the Indian Accounting Standard (Ind AS), a joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

Joint Venture commonly referred to as a "JV", are typically formed either by individuals, business entities, corporations or partnerships. The contributions to the joint ventures are either in the form of money [capital], services, or physical asset(s), i.e. equipment or intellectual property [software, patents], etc., or a combination of all. Business entities, who do not individually have the capacity, in terms of resources finances and technical know-how etc. can benefit by forming Joint Venture for pooling of resources, sharing technical know-how and exploring larger markets for their goods and services.

JVs are also common in the manufacturing, mining, and service industries. A JV may be formed to conduct research and development work on a new product or technical application, to manufacture or produce various products, to market and distribute products and services in a specified geographic area, or to perform a combination of these functions.

### Advantages of Forming Joint Venture

i. **Risk Sharing:** Risk sharing is one of the biggest advantages of forming a Joint Venture, particularly, in those industries where the cost of product development and likelihood of failure of any particular product is very high.

ii. **Economies of Scale:** Another advantage of forming a JV is for the industries which have high fixed costs, a JV with a larger company can provide the economies of scale necessary to compete locally or globally and can be an effective way by which two companies can pool resources and achieve critical mass.

iii. **Market Access:** For companies that lack a basic understanding of customers and the relationship and infrastructure to distribute their products to customers, forming a JV with the right partner can provide instant access to established, efficient and effective distribution channels and receptive customer bases. This is important to a company because creating new distribution channels and identifying new customer bases can be extremely difficult, time consuming and expensive activities.

iv. **Exploring the Global Market:** Formation of JV can be advantageous to those companies, which are foreseeing an attractive business opportunity in a foreign market. Partnering with foreign company would provide an ease to that Company for penetrating a foreign market, which can otherwise be difficult both because of a lack of experience in such market and local barriers to foreign-owned or foreign-controlled companies.

v. **Easy acquisition of other entity or business:** When a company wants to acquire another, but cannot due to cost, size, or geographical restrictions or legal barriers, teaming up with a JV Partner can be an attractive option. The JV is substantially less costly and thus less risky than complete acquisitions, and is sometimes used as a first step to a complete acquisition with the JV Partner. Such an arrangement allows the purchaser the flexibility to cut its losses if the investment proves less fruitful than anticipated.

vi. **Cost Efficiency:** For a small-scale company/ entity, sometimes it is difficult to set up the infrastructure and the machinery required product development. In the moment of need, joint venture is the perfect solution. For example, if a company has a plan for the perfect product, however, due to financial shortage there is not enough machinery or resources available. At such a time, if another company, which is equipped, lends a hand in the form of joint venture, by way of resource sharing and cost sharing it becomes easier to produce.

vii. **Flexible nature:** The joint venture enterprises provide flexibility, each participant has the freedom to continue with their individual businesses. The joint venture participants can only interfere within the participated project. Thus, during the term of the contract participants can freely resume their business as long as they fulfil the needs mentioned in the agreement.

## Disadvantages of Joint Venture

Disadvantages of forming Joint Venture are as follows:

i. **Restricted flexibility where full concentration is required for JV Project:** Flexibility is important however, some projects require full concentration and thus the simultaneous work may become impossible. In times like such the participants need to focus on the product of the joint venture and the individual businesses suffer in the process. For example, company A requires technological assets thus in joint venture company B avails the facility. In the same time, if the company B requires those technical assets then he has to postpone the individual project for the time being.

ii. **Lack of equal involvement:** An equal involvement from all the Joint Venture partners may not be possible. It is extremely unlikely for all the companies working together to share the same involvement and responsibilities.

iii. **Cultural Differences:** Different cultures and management styles may result in poor co-operation and integration. People with different beliefs, tastes, and preferences can create hurdles.

iv. **Extensive Research and planning required:** Joint venture can result in a frustrating experience and ultimately a failure if it lacks adequate planning and research.

v. **Lack of clear communication:** A joint venture involves different companies from different horizons with different goals, there is often a severe lack of communication between partners.

vi. **Unreliable partners:** Because of the separate nature of a joint venture, it is possible that the partner do not devote 100% of their attention to the project and become unreliable.

vii. **Creation of competitor:** Another potential disadvantage of a JV is the possibility of the creation of a competitor or a potential competitor in the form of one's own joint venture partner.

## Strategies of entering into a Joint Venture

Strategies of Joint Venture

- Identification of Prospective JV Partners
- Reliable Partners
- Strong JV Relationship
- Equal Contribution
- Written Agreement
- Limiting Scope of JV
- Defined Business Model
- Flexibility
- Exit Routes

Joint ventures can be very effective for growth and success of a business. If formed strategically Joint Ventures can be extremely valuable and chances of their failure can be reduced to a greater extent.

**Following are the strategies for forming a successful Jointing Venture:**

- **Identification of prospective Joint Venture Partner(s):** The prospective partner should be strong in terms of business, technology and resources. One partner must be able to compliment the other partner especially in those areas where it lacks. For example, one entity's strength is economies of scale and another entity's strength is strong marketing and their brand value. Both the entities, if formed into JV can complement each other and they can have a larger market for their products.
- **Trustworthy:** Joint Venture Partner should never be weak or untrustworthy partner, as it would definitely lead to failure of the joint venture. On the other hand, a JV with strong and trustworthy partner would generate enormous benefits for both the partners and the Joint Venture entity.

- **Development of Strong Joint Venture Relationship:** Partners must strive to develop joint venture relationships that are easy to maintain, financially profitable, intellectually rewarding, and long-lasting. After a necessary period of negotiation and implementation, the Joint Venture relationship should grow well quickly and painlessly.
- **Equal Contribution:** Joint Venture Partners must make sure that all the partners have equal contribution in the Joint Venture entity in terms of skills, intellectual resources, marketing resources, capital, and so on. Unbalanced or unequal contributions are never healthy for the success of a Joint Venture entity.
- **Written Agreement:** The agreement between two or more parties always be written and must clearly define all the terms, relates to rights and responsibilities of each partner. The language of the agreement must be simple and there should be no ambiguity, also there should be no clashing of interest.
- **Limiting the scope of Joint Venture:** It is essential that limits and scope of the venture should be defined in the beginning itself. At a later stage, once the trust amongst the partners is developed, the scope of Joint Venture can be increased with the mutual consent of all the partners.
- **Well defined Business Model:** The firms in a JV must clearly define the nature of the new venture including the proposition to the customer, the channels and relationship management, the value chain, the structure and roles, investments, income, costs and payments, success factors and the timetable for delivery. A well-defined business model provides a base for the legal and financial framework.
- **Flexibility:** The partners in JV should try to be flexible and favour partners who demonstrate the same level of flexibility.
- **Establishment of Exit Routes:** JV Partners much establish clear protocols in the beginning itself for amending or unwinding the relation if it fails to meet the expectations or in case there arises any dispute.

## Formation of Joint Ventures

A Joint Venture can be of the following types:

### 1. Equity based Joint Venture

The equity joint venture is an arrangement whereby a separate legal entity is created in accordance with the agreement of two or more parties.

The parties undertake to provide money or other resources as their contribution to the assets or other capital of that legal entity. The entity is generally established as a limited liability company and is distinct from either of the parties which participate in its creation.

The newly created company, thus, becomes the owner of the resources contributed by the parties to the joint venture arrangement. Each of the parties in turn becomes the owner of the company having equity in the company.

The parties to a joint venture agreement agree on purposes and functions of the newly created entity, the proportion of capital contribution by each party and the share of each party in the profits of the company and on other matters such as its management, operation, duration and termination.

Generally speaking, in an equity based joint venture, the profits and losses of the jointly owned entity are distributed among the parties according to the ratio of the capital contributions made by them. However, the division of profits and losses is not the only characteristic of an equity-based joint venture. The key characteristics of equity-based joint ventures are as following:

a) There is an agreement to either create a new entity or for one of the parties to join into ownership of an existing entity
b) Shared Ownership by the parties involved.
c) Shared management of the jointly owned entity.
d) Shared responsibilities regarding capital investment and other financing arrangements.
e) Shared profits and losses according to the JV Agreement.

**Circumstances indicating SPV:**

All the above five characteristics need not be fulfilled in every equity based joint venture. For example, one of the parties to the agreement may be providing investment but might not have any say in the management of the Joint Venture.

Again, a foreign company may want to exercise management control even though it is not investing in the JV company. Typically, if a foreign company is providing technology and other knowledge-based inputs, it may want to ensure that the JV company is managed as per its directions. In such cases, the foreign company may retain an option to invest in the JV Company on a later date. This may be done by a foreign company to create a foothold for itself in a sector where Foreign Direct Investment (FDI) is not allowed.

2. **Contractual Joint Venture**

The contractual joint venture might be used where the establishment of a separate legal entity is not needed or the creation of such a separate legal entity is not feasible in view of one or the other reasons. The two parties do not share ownership of the business entity but each of the two parties exercises some elements of control in the joint venture.

The contractual joint venture agreement can be entered into in situations where the project involves a narrow task or a limited activity or is for a limited term or where the laws of the host country do not permit the ownership of property by foreign citizens.

For the purposes of contractual joint venture, the relationship between parties is set forth in the contract or agreement concluded between them.

The way joint venture company would carry out its operations is always based on the negotiations between the parties, the results of which reflect in the joint venture agreement entered into between the parties.

The licensing agreement, know-how agreement, technical services or technical assistance agreement, franchise agreement and agreement covering all other commercial matters might even form annexes to the main joint venture agreement. These can be signed once the joint venture company is established.

An example of a contractual joint venture is a franchisee relationship. The key characteristics of such a relationship are:

i. Two or more parties have a common intention – of running a business venture.
ii. Each party will bring some inputs in the form of money, technology or materials.
iii. Each party exercises certain degree of control on the venture.
iv. The relationship is not a transaction-to-transaction relationship but has a character of relatively longer time duration.

The above four characteristics are the distinguishing features of a Contractual Joint Venture as opposed to an Equity based relationship.

It is important to note that a joint venture agreement, be it for the establishment of a limited liability company or not, and the different contracts must be concluded in accordance with laws and regulations applicable to such companies including tax laws concerning these companies or the laws relating to agency or partnership as well as other economic laws, in addition to laws relating to labour, sales of goods, insurance and foreign economic and trade contract.

Every equity based joint venture gives birth to a new entity. Government of India permits certain type of entities. Different types of entities are summed up below:

1. **Company** – A limited liability company is the most preferred structure for joint venture entities in India.

   Government also encourages investment being in the form of equity capital of a company incorporated in India. Companies in India are mainly of two types – private limited and public limited. There is no minimum share capital prescribed either for private limited company or public limited company.

   A private limited company must have at least two shareholders, while a public limited company must have seven shareholders. The only exception to this is a one-person company. The shareholders may be foreign citizens or foreign companies. Companies Act 2013 makes it mandatory that at least one director of every company is resident of India.

2. **Limited Liability Partnership (LLP) Firm** – LLP Firm structure is regulated in India by The Limited Liability Partnership Act, 2008. Foreign investment in LLP Firms was not permitted before November 2015. Government of India has now allowed foreign investments in LLP firms subject to certain restrictions.

   LLP Firms are partnership firms with limited liability of partners. An LLP Firm combines the convenience of a partnership firm with the limited liability feature earlier found only in a company. An LLP Firm needs minimum two partners. It also requires minimum two Designated Partners out of which at least one should be resident of India. The two partners can also be appointed as Designated Partners. There is no requirement of minimum capital contribution to incorporate an LLP Firm.

3. **Venture Capital Fund** – A duly registered Foreign Venture Capital Investor is allowed to contribute up to 100% in Indian Venture Capital Undertakings /Venture Capital Funds / other companies.

4. **Trusts** – A foreign company is not allowed to use Trust as a form of a joint venture entity in India. SEBI has introduced regulations for some funds like Real Estate Investments Trusts, Infrastructure Investment Funds, Alternative Investment Funds. Such funds are now permitted to receive foreign investment from a person resident outside India.
5. **Other Entities** – Foreign companies are not allowed to use any structures other than those mentioned above for the purpose of equity based joint venture entities.

## Restrictions under FDI Policy of the Government of India

Typically, any non-resident entity can set up an equity based joint venture in India. However, some entities face restrictions under FDI Policy of Government of India. The restrictions are as follows:

1. A Citizen or entity land border from India as per FDI Policy 2020 can invest only after the approval of the Government of India. Entity invest in defense, space, atomic energy and sectors prohibited for foreign investment.
2. NRI residents in Nepal and Bhutan as well as citizens of Nepal and Bhutan can invest on repatriation basis subject to investment coming in free foreign exchange (USD or EURO) through normal banking channels.
3. A Foreign Institutional Investor (FII) can invest only under the Portfolio Investment Scheme with certain limits.
4. A Foreign Venture Capital Investor (FVCI) duly registered in India may contribute up to 100% of the capital of an Indian Company under the automatic route and may also set up a domestic asset management company to manage the fund. Such investments are subject to the relevant RBI Rules and Regulations and FDI policy including sectoral caps, etc. SEBI registered FVCIs are also allowed to invest under the FDI Scheme, as non-resident entities, in other companies.

## Documents for Joint Ventures

Finalization of a joint venture goes through many stages. The first may be called the familiarisation stage when the two partners generally attempt to know each other.

The second may be called the engagement phase when there is a level of commitment but still it is not very firm or long-term. The final stage is when broad understanding has been reached on the terms of the Joint Venture.

At each stage, the documentation is different. The Indian companies preferred to have a Memorandum of Understanding (MOU) to define the relationship at the initial stage. The MOU is a brief document without much legal jargon. The MOU states the duties of both parties and lays down a road map for the future. During the engagement phase, a contractual Joint Venture may be envisaged. The parties are putting in relatively higher amount of resources at this stage. Hence, it is customary to have well-drafted legally binding contracts.

The contracts are generally of a fixed duration or are related to specific events like getting an order or achieving certain sales volumes. At the concluding stage, the parties have developed higher confidence in each other. So, an equity-based joint venture is considered.

The documentation for an equity Joint Venture must take into account all possibilities that may arise over a fairly long period of time.

Hence, the Joint Venture Agreement or Shareholders' Agreement or LLP Partnership Deed must be prepared carefully to avoid any confusion even many years down the line. Generally speaking, most equity Joint Ventures in India are structured in the form of private or public limited liability companies. In a company, Articles of Association is a very important document. Companies Act, 2013 gives the promoters freedom to draft the articles as per their requirements. It is hence, advisable to devote time and attention to the Articles and not depend on a standard off- the-shelf draft, especially in case of a joint venture company where one of the partners is a foreign national / company.

## Essential Features of a Shareholders' Agreement (SHA) /Joint Venture Agreement / Partnership Agreement (PA)

The SHA / PA is not a document for the government or the courts. SHA / PA is a working document and should be drafted with business essentials in focus. The key questions that an SHA / PA must address are common- sense ones that any entrepreneur is bound to ask when he / she joins hands with another entrepreneur.

Some of the key issues which must be kept in mind while drafting the SHA/PA are summarised below:

i. The business of the new company/LLP;
ii. Manner and extent to which resources (financial, manpower, technology, etc) will be brought in;
iii. Provisions relating to allotment and transfer of shares;
iv. Constitution of the Board of Directors/Designated Partners;
v. Manner in which decision making will take place (majority vote or consensus);
vi. Decision regarding the Chairman and Managing Director of the entity; their rights, duties and responsibilities;
vii. Persons responsible for managing finances, marketing, production, etc.;
viii. Dividend distribution policy;
ix. Term of office of the nominated directors, the manner of their appointment and changes among them;
x. Valuation of the company at the time of separation;
xi. Dispute resolution mechanism.

The above examples are indicative and are not exhaustive.

## Essential components of a Joint Venture Agreement

In India, there is no legally prescribed format of a Joint Venture Agreement. However, in actual practice, the Agreement contains the following components (illustrative and not exhaustive):

a) Description (Nature of the Agreement)
b) Parties (full description of the parties to the Agreement)
c) Recitals (states the situation as it existed prior to the execution of this Agreement; It is also used to convey the intention of the parties)

d) Operative Part (defines the rules for the future; typically consists of name and constitution of the new entity being set up, equity investments, rules relating to loans by either party, activities to be undertaken, role of each party, constitution of the Board, names of the Chairman and Managing Director and their powers, duties, etc. matters to be decided by consensus, managerial remuneration, milestones to be reached and plan of action)

e) Legal aspects:

i. Amendments of the JV Agreement
ii. Duration of the JV
iii. Termination
iv. Dispute resolution by amicable consultation and/or Arbitration mechanism/Alternate form of Dispute Resolution
v. Courts of particular State (in India) or Country (where the JV partner is foreign entity) that will have the jurisdiction in the event of dispute
vi. Confidentiality and Non-Disclosure Agreement
vii. Non-compete clause
viii. Indemnification
ix. Procedure for execution.

## SPECIAL PURPOSE VEHICLE (SPV)

### Meaning of Special Purpose Vehicle (SPV)

A Special Purpose Vehicle (SPV) or Special Purpose Entity (SPE) are generally formed for a special purpose. Scope of these kind of companies or entities are limited only to those activities which are required to be performed to attain that specific purpose. These companies/entities close their operations once the purpose is attained. The operations of these entities are limited to the acquisition and financing of specific assets. SPVs are generally a subsidiary company whose obligations are secured even if the parent company goes bankrupt.

An SPV can be formed for any lawful purpose. No SPV can be formed for an unlawful purpose, or for undertaking activities which are contrary to the provisions of law or public policy. An SPV is, primarily, a business association of persons or entities eligible to participate in the association.

A SPVs/SPEs may be formed through limited partnerships, trusts, corporations, limited liability corporations or other entities. An SPV/SPE may be designed for independent ownership, management and funding of a company or as protection of a project from operational or insolvency issues. SPVs help companies securitize assets, create joint ventures, isolate corporate assets or perform other financial transactions.

Thus, based on above meaning, we can conclude that a SPV is an entity which has distinct identity from its promoters or sponsors or constituents or shareholders.

To give an example, the implementation of the Mission (under the Smart Cities Mission Project of the Ministry of Housing & Urban Affairs, Government of India) at the City level will be done by a Special Purpose Vehicle (SPV) created for the purpose. The SPV will plan, appraise,

approve, release funds, implement, manage, operate, monitor and evaluate the Smart City development projects. Each smart city will have a SPV which will be headed by a full time CEO and have nominees of Central Government, State Government and ULB on its Board. The SPV will be a limited company incorporated under the Companies Act, 2013 at the city-level.

## Benefits of Special Purpose Vehicle (SPV)

The biggest advantage of SPV is that it helps in separating the risk and freeing up the capital. As a result, the SPV and the sponsoring company are protected against risks like insolvency, which may arise during the course of operation. The SPV also allows securitisation of assets without disturbing the managerial relationship. Under the arrangement, any predictable income stream generated by secure assets can be securitised.

**Model SPV:**

a) Ownership of Assets – An SPV allows the ownership of a single asset often by multiple parties and allows for ease of transfer between parties.
b) Minimum Statutory Requirement – Depending on the choice of jurisdiction, it is relatively cheap and easy to set up an SPV.
c) Clarity of documentation – It is easy to limit certain activities or to prohibit unauthorised transactions within the SPV documentation.
d) Tax benefits – SPVs are often used to make a transaction tax efficient by choosing the most favourable tax residence for the vehicle. SPVs are method of financial engineering schemes which have as their main goal, the avoidance of tax. Some countries have different tax rates for capital gains and gains from property sales.
e) Legal protection – By structuring the SPV appropriately, the sponsor may limit legal liability in the event that the underlying project fails.
f) Accounting Reasons – Debts raised through SPV are not reflected in the balance sheet of the sponsor. It reflects a pleasant picture and enhances the debt raising ability of the sponsor. Losses incurred by SPV are not shown in the balance sheet of the sponsor, so it helps to maintain the healthy picture of the sponsor in the eyes of its stakeholders.
g) The key advantage is that it helps in separating the risk and freeing up the capital. As a result, the SPV and the sponsoring company are protected against risks like insolvency, which may arise during the course of operation.
h) The SPV also allows securitization of assets without disturbing the managerial relationship. Under the arrangement, any predictable income stream generated by secured assets can be securitized.

## Purpose of Special Purpose Vehicle

The main purpose of a Special Purpose Vehicle is to allow the parent company to make highly leveraged or speculative investments without endangering the entire company. If the SPV goes bankrupt, it will not affect the parent company. SPVs are mostly formed to raise funds from the market or when Government Regulations specify creation of a separate vehicle for carrying out any specified activity.

SPVs are created by a parent company to implement large-scale projects and operations of an SPV are legally limited to specific assets.

SPVs are also formed by banks and financial institution for Securitisation. The total assets of banks or financial institution mainly comprise of loans and receivables along with their future cash flow to a separate entity, which may be formed for a specific purpose. The SPV is allowed to raise debt which will be backed by these receivables and their future cash flows. The difference between the incomes received from these receivables and cost of servicing that debt will be profit/earning of the SPV. By securitization through SPV the risk involved in this activity is separated from the general business of the bank.

Indirect acquisition of assets - SPVs can be used for acquiring assets indirectly for the purpose of tax saving. In this method, the sponsor takes the assets on lease from its SPV. Expenses incurred as rent, is allowed as a deduction to sponsor for income tax purpose. On the other hand, the SPV acquires the asset through raising debt, the interest on which is a deductible expense for tax purpose. This way the same asset can be used to claim deduction by both, which results in saving of tax.

Government also forms SPVs for special projects. Purpose behind formation of SPV is to get easy finance and various approvals from State and Central Government at many levels and on completion of projects, it provides easy exit route for Government.

## Difference between a Special Purpose Vehicle (SPV) and a Company

SPVs are mostly formed to raise funds from the market. Technically, an SPV is a company. It has to follow the rules of formation of a company laid down in the Companies Act. Like a company, the SPV is an artificial person. It has all the attributes of a legal person. It is independent of members subscribing to the shares of the SPV. The SPV has an existence of its own in the eyes of law. It can sue and be sued in its name. The SPV has to adhere to all the regulations laid down in the Companies Act. Members of an SPV are mostly the companies and individuals sponsoring the entity. An SPV can also be a partnership firm.

The company, as distinguished from an SPV, may be called a general purpose vehicle. A company may do many things which are mentioned in the memorandum of association (MoA) or permitted by the Companies Act. An SPV may also do the same, but its scope of operation is limited and focused. If it is not so, the SPV had better be called a company. The MoA is quite narrow in the case of an SPV. This is primarily to provide comfort to lenders who are concerned about their investment.

## How is an SPV established?

Like a company, an SPV must have promoter(s) or sponsor(s). Usually, a sponsoring corporation hives off assets or activities from the rest of the company into an SPV. This isolation of assets is important for providing comfort to investors. The assets or activities are distanced from the parent company, hence the performance of the new entity will not be affected by the ups and downs of the originating entity. The SPV will be subject to fewer risks and thus provide greater comfort to the lenders. What is important here is the distance between the sponsoring company and the SPV. In the absence of adequate distance between the sponsor and the new entity, the later will not be an SPV but only a subsidiary company.

A good SPV should be able to stand on its feet, independent of the sponsoring company. Unfortunately, this does not happen in practice. One of the reasons for the collapse of the

Enron SPV was that it became a vehicle for furthering the ends of the parent company in violation of the prudential norms of corporate financing and accounting.

## SPV as preferred vehicle for funds raising by Infrastructure Sector

The funds requirement for Infra structure sector are huge. There are different organisations, like the Infrastructure Development Finance Company (IDFC), Power Finance Corporation (PFC), Indian Rail Finance Corporation (IRFC) etc., which are engaged in raising funds for development of infrastructure sector projects for the sectors they are involved in. The proposed SPV, which is likely to be a government company, will add to the availability of long-term funds for infrastructure sector projects.

Further. The implementation of the Smart Cities Mission at the City level done by a Special Purpose Vehicle (SPV) created for the purpose. The SPV plan, appraise, approve, release funds, implement, manage, operate, monitor and evaluate the Smart City development projects. The execution of projects may be done through joint ventures, subsidiaries, Public-Private Partnership (PPP), turnkey contracts, etc suitably detailed with revenue streams.

## LLP FIRM AS A SPECIAL PURPOSE VEHICLE

A Limited Liability Partnership (LLP) Firm combines the simplicity of a partnership firm with the advantage of limited liability as available in the case of a company.

Before the passing of The Limited Liability Partnership Act in 2008, a foreign company intending to participate in tender or some other project in consortium with an Indian company had only the option of setting up a company (whether private or public) as a Special Purpose Vehicle (SPV). The disadvantage was that winding up such a company is difficult.

Foreign companies are not permitted to invest in partnership firms.

Moreover, consortium members do not want to be saddled with unlimited liability as is the case in a partnership firm under The Indian Partnership Act, 1932. Till November 2015, foreign companies were not allowed to invest in any form of structure except a company. Foreign Investment in some LLP firms has been allowed now.

LLP firm as an SPV between a foreign company and an Indian company has the advantage of being easy to wind up after the purpose is over and the liability of the two partner companies is limited. Key advantages of using an LLP firm as an SPV as compared to a company are as follows:

a) Low cost of incorporation of an LLP;
b) Flexibility of rules of management and governance based on Agreement between the contracting Partners;
c) Partners can be companies while management is by Designated Partners who are individuals. By this, there is divorce between ownership and management;
d) Low annual maintenance cost;
e) There may not be any necessity of getting the accounts audited before the project takes off;
f) An LLP firm does not have to pay Dividend Distribution Tax (DDT) on share of profits transferred to the Partners, which makes it tax efficient;

g) Voluntary winding of an LLP firm which has no creditors is very easy and can be done without intervention of any court or tribunal;
h) Investment in LLP Firms is permitted only in sectors in which 100% FDI is permitted through automatic route without any performance linked conditions.

# Chapter 10 : Setting up of Branch Office/ Liaison Office/ Wholly Owned Subsidiary by Foreign Company

## INTRODUCTION

With India possessing vast natural and human resources and being among the fastest-growing economies in the world with a large market, it provides immense opportunities for foreign companies to grow and diversify their business. Therefore, there is a lot of interest among foreign companies and foreign nationals to open a wholly owned subsidiary, branch, liaison or project office in India or start a business in India.

Foreign company can also open an office in India without starting necessarily as a subsidiary company or associate company. There are basically three ways for a foreign company to conduct business/activities in India without starting a subsidiary company in India. Branch Office / Liaison Office allow for long-term functioning of a foreign company's office in India with approval from the Reserve Bank of India, while project offices can be started under General approval of the Reserve Bank of India if certain criteria are fulfilled.

There are mainly two types of entry strategy for foreign businesses in India, registration of a company or establishing a branch, liaison and project office:

- **Incorporation of a private limited company:** It is the easiest and fastest type of India entry strategy for foreign nationals and foreign companies. Foreign direct investment of upto 100% into a private limited company or limited company is under the automatic route, wherein no Central Government permission is required. Hence, incorporation of a private limited company as a wholly-owned subsidiary of a foreign company or joint venture is the cheapest, easiest and fastest entry strategy for foreign companies and foreign nationals into India.
- **Registration of Branch Office, Liaison Office or Project Office:** It requires RBI and/or Government approval. Therefore, the cost and time taken for registration of branch office, liaison office or project office for a foreign company are higher than the cost and time associated with incorporation of a private limited company. Further, foreign nationals cannot open a branch office, liaison office or project office. Hence, this option is limited to being an India entry strategy only for foreign companies.

Branch Office, Liaison Office or Project Office are unincorporated place of business of foreign company in India and are regulated by the Companies Act as well under FEMA.

## Important Terms

As per Section 2(42) of the Companies Act, 2013, "Foreign Company" means any company or body corporate incorporated outside India which–

(a) has a place of business in India whether by itself or through an agent, physically or through electronic mode; and
(b) conducts any business activity in India in any other manner.

As per Section 2(87) of the Companies Act, 2013, 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 –

(i) controls the composition of the Board of Directors; or
(ii) exercises or controls more than one-half of the 19[total voting power] either at its own or together with one or more of its subsidiary companies:

Provided that such class or classes of holding companies as may be prescribed shall not have layers of subsidiaries beyond such numbers as may be prescribed.

Explanation. –For the purposes of this clause, –

(a) a company shall be deemed to be a subsidiary company of the holding company even if the control referred to in sub-clause (i) or sub-clause (ii) is of another subsidiary company of the holding company;
(b) the composition of a company's Board of Directors shall be deemed to be controlled by another company if that other company by exercise of some power exercisable by it at its discretion can appoint or remove all or a majority of the directors;
(c) the expression "company" includes any body corporate;
(d) "layer" in relation to a holding company means its subsidiary or subsidiaries.

## Key Provisions

Further, as per the Foreign Exchange Management (Establishment in India of a branch office or a liaison office or a project office or any other place of business) Regulations, 2016, Branch Office, Liaison Office or Project Office are defined as follows:

- 'Branch Office' in relation to a company, means any establishment described as such by the company.
- 'Liaison Office' means a place of business to act as a channel of communication between the principal place of business or Head Office or by whatever name called and entities in India but which does not undertake any commercial /trading/ industrial activity, directly or indirectly, and maintains itself out of inward remittances received from abroad through normal banking channel.
- 'Project Office' means a place of business in India to represent the interests of the foreign company executing a project in India but excludes a Liaison Office.

## Sections 379 to 393A under Chapter XXII of the Companies Act, 2013 ('Act') deal with Companies Incorporated Outside India.

Section 379 of the Act provides that where not less than 50% of the paid-up share capital, whether equity or preference or partly equity and partly preference of a foreign company is held by one or more citizens of India or by one or more bodies corporate incorporated in India, whether singly or in the aggregate, such company shall comply with such of the provisions of this Act, as may be prescribed by the Central Government with regard to the business carried on by it in India, as if it were a company incorporated in India.

Section 380 of the Act lays down that every foreign company which establishes a place of business in India must, within 30 days of the establishment of such place of business, file with the Registrar of Companies for registration:

(a) a certified copy of the charter, statutes or memorandum and articles, of the company or other instrument constituting or defining the constitution of the company and, if the instrument is not in the English language, a certified translation thereof in the English language;
(b) the full address of the registered or principal office of the company;
(c) a list of the directors and secretary of the company containing such particulars as prescribed;
(d) the name and address or the names and addresses of one or more persons resident in India authorised to accept on behalf of the company service of process and any notices or other documents required to be served on the company;
(e) the full address of the office of the company in India which is deemed to be its principal place of business in India;
(f) particulars of opening and closing of a place of business in India on earlier occasion or occasions;
(g) declaration that none of the directors of the company or the authorised representative in India has ever been convicted or debarred from formation of companies and management in India or abroad; and
(h) any other information as prescribed.

Every foreign company has to ensure that the name of the company, the country of incorporation, the fact of limited liability of members is exhibited in the specified places or documents as required under Section 382.

Section 381 of the Act requires a Foreign Company to maintain books of Account and file a copy of balance sheet and profit and loss account in prescribed form with ROC every calendar year. These accounts should be accompanied by list of place of business established by the foreign company in India.

Sections 380 to 386 (both inclusive) and sections 392 and 393 of the Act shall apply to all foreign companies.

As regards the applicability of the provisions of the Act to foreign companies, the following provisions of section 384 are to be noted:

Section 376 of the Act provides further that when a foreign company, which has been carrying on business in India, ceases to carry on such business in India, it may be wound up as an unregistered company under Sections 375 to 378 of the Act, even though the company has been dissolved or ceased to exist under the laws of the country in which it was incorporated.

(i) The provisions of section 71 relating to Debentures shall apply mutatis mutandis to a foreign company.
(ii) The provisions of Section 92 regarding (filing of annual returns) and Section 135 (Corporate Social Responsibility) shall, subject to such exceptions, modifications or adaptations as may be made therein by the rules made under the Act, apply to a foreign company as they apply to a company incorporated in India.

(iii) The provisions of Section 128 relating to the (to the extent of requiring it to maintain at its principal place of business in India books of account with respect to moneys received and spent, sales and purchase made and assets and liabilities, in the course of or in relation to its business in India), Section 209A (inspection of accounts), Section 233A (Special audit), Section 233B (audit of cost accounts), Section 234-246 (investigations), so far as may be, apply only to the Indian business of a foreign company having an established place of business in India as they apply to a company incorporated in India.

(iv) The provisions of Chapter VI (Registration of Charges) shall apply mutatis mutandis to charges on properties which are created or acquired by any foreign company.

(v) The provisions of Chapter XIV (Inspection, Inquiry and Investigation) shall apply mutatis mutandis to the Indian business of a foreign company as they apply to a company incorporated in India.

As per Section 386(c) of the Act, having a share transfer office or registration office will constitute a place of business. In Tovarishestvo Manufacture Liudvig Rabenek, Re [1944] 2 All ER 556 it was held that where representatives of a company incorporated outside the country frequently stayed in a hotel in England for looking after matter of business, it was held that the company had a place of business in England.

In a certain case, it was held that mere holding of property cannot amount to having a place of business.

## Provisions pertaining to name

As per Rule 8 of the Companies (Incorporation) Rules, 2014 ("hereinafter referred to as the Rules") states that if a foreign company is incorporating its subsidiary company in India, then the original name of the holding company as it is may be allowed with the addition of word India or name of any Indian State or city, if otherwise available.

Provided further that provisions of Rule 8 shall apply mutatis mutandis while determining whether a proposed name is too nearly resembling the name of a company or limited liability partnership incorporated outside India.

The name shall be considered undesirable, if-

- The proposed name implies association or connection with an embassy or consulate of a foreign government.
- The proposed name includes name of any foreign country or any city in a foreign country, the same shall be allowed if the applicant produces any proof of significance of business relations with such foreign country like memorandum of understanding with a company of such country.

Provided that the name combining the name of a foreign country with the use of India like India Japan or Japan India shall be allowed if, there is a government to government participation or patronage and no company shall be incorporated using the name of an enemy country.

# ESTABLISHMENT OF BRANCH OFFICE (BO)/ LIAISON OFFICE (LO)/ PROJECT OFFICE (PO) IN INDIA

Establishment of branch office/ liaison office / project office or any other place of business in India by foreign entities is regulated in terms of Section 6(6) of Foreign Exchange Management Act, 1999 read with Foreign Exchange Management (Establishment in India of a branch office or a liaison office or a project office or any other place of business) Regulations, 2016 as amended from time to time.

## Branch Office

A branch office is a suitable business model for foreign companies looking to establish a temporary presence in India. The branch office serves as an extension of the head office business and carries on the same business and activity as that of its parent company.

Branch office in relation to a company, means any establishment described as such by the company. These BOs represent the parent company and usually undertake the same activities as the latter. The profits from these are easily remittable from India, subject to the taxes applicable.

## Eligibility for setting up a Branch Office

- The applicant company must be a body corporate incorporated outside India;
- The name of the Indian branch office must be the same as the parent company (if the branch office does not have revenue from India operations, its expenses must be met by the head office);
- The net worth of the branch office must not be less than US $100,000; and
- The parent company should have a profit making record in the immediately preceding five financial years in the home country.

In cases where the applicant foreign entity does not meet the financial criteria, the parent company may issue a Letter of Comfort (LoC), given the company satisfies the prescribed criteria for net worth and profit.

## Permitted Activities

In India, a branch office cannot directly carry out manufacturing activities unless such manufacturing activity is done in a special economic zone (SEZ) with the purpose of exporting products out of India. It may also subcontract such activity to an Indian manufacturer.

Furthermore, following activities are permitted for a branch office in India of a person resident outside India:

(i) Export/import of goods.
(ii) Rendering professional or consultancy services.
(iii) Carrying out research work in which the parent company is engaged.
(iv) Promoting technical or financial collaborations between Indian companies and parent or overseas group company.
(v) Representing the parent company in India and acting as buying/ selling agent in India.
(vi) Rendering services in Information Technology and development of software in India.
(vii) Rendering technical support to the products supplied by parent/group companies.

(viii) Representing a foreign airline/shipping company.

A branch office is not allowed to undertake any Retail Trading Activities. Manufacturing or Processing activities, undertaken directly or indirectly, are also barred.

The RBI has given general permission to foreign companies to set up branch offices in Special Economic Zones (SEZs) subject to the following conditions:

1. such BOs are functioning in those sectors where 100 per cent FDI is permitted;
2. such BOs comply with Chapter XXII of the Companies Act, 2013;
3. such BOs function on a stand-alone basis.

Every Branch Office has to deliver documents as specified in Section 380 of the Companies Act, 2013 within thirty days of its establishment to the Registrar.

## Registration of a Branch Office in India

Foreign company must apply for approval from the Reserve Bank of India (RBI) under provisions of the Foreign Exchange Management Act (FEMA), 1999 to open a branch office in India.

Foreign entities whose principal business falls under sectors where 100 per cent foreign direct investment (FDI) is permissible under the automatic route must complete the form FNC and submit it to the RBI, along with the associated documents.

For other sectors, the form must be submitted to the Ministry of Finance. In this case, the application for establishing branch office must be forwarded by the foreign entity through a designated AD Category – I bank to the RBI.

If the foreign entity wishes to establish a branch office in more than one location in India, it must register the branch, or seek approval from the RBI for each of the location separately. The RBI approval is also necessary for each activity the branch office intends to undertake in India.

The procedures for registration requires a foreign company to deposit the following set of forms:

- FNC form duly signed by AR;
- Information about the parent company along with its certificate of incorporation attested by a Notary Public or the Indian Embassy in the country of registration;
- The incorporation documents of the branch office to be established in India;
- Proof of registered office;
- Note on location or proposed activity;
- The latest audited balance sheet of the applicant entity;
- Board resolution to open a branch office;
- KYC of the authorized signatory; and
- Information about the local representatives of the parent company in the branch office.

## Funding of the BO by the Foreign Company

A. Equity Share Capital: in the usual way Indian companies are financed.
B. Preferred Share Capital: such convertible preference shares, compulsorily convertible into equity shares are regarded as Foreign Direct Investment (FDI).

C. Debentures and Borrowings: there can be redeemable, convertible or non-convertible. Companies can issue debentures, bonds and other debt securities. These also, when convertible into equity shares, are treated as FDI.

## LIAISON OFFICE

Liaison Office means a place of business to act as a channel of communication between the principal place of business or Head Office or by whatever name called and entities in India but which does not undertake any commercial /trading/ industrial activity, directly or indirectly, and maintains itself out of inward remittances received from abroad through normal banking channel.

## Eligibility for setting up a Liaison office

- The applicant company must be a body corporate incorporated outside India;
- The name of the Indian branch office must be the same as the parent company (if the branch office does not have revenue from India operations, its expenses must be met by the head office);
- The net worth of the liaison office must not be less than US $ 50,000; and
- The parent company should have a profit making record in the immediately preceding three financial years in the home country.

In cases where the applicant foreign entity does not meet the financial criteria, the parent company may issue a Letter of Comfort (LoC), given the company satisfies the prescribed criteria for net worth and profit.

## Permitted Activities

(i) Representing the parent company / group companies in India.
(ii) Promoting export / import from / to India.
(iii) Promoting technical/ financial collaborations between parent / group companies and companies in India.
(iv) Acting as a communication channel between the parent company and Indian companies.

The Hon'ble Supreme Court vide its interim orders dated July 4, 2012 and September 14, 2015, passed in the case of the Bar Council of India vs. A. K. Balaji & Ors., has directed RBI not to grant any permission to any foreign law firm, on or after the date of the said interim order, for opening of LO in India.

The Hon'ble Supreme Court has while disposing of the case, held that advocates enrolled under the Advocates Act, 1961 alone are entitled to practice law in India and that foreign law firms/companies or foreign lawyers cannot practice profession of law in India. As such, foreign law firms/companies or foreign lawyers or any other person resident outside India, are not permitted to establish any branch office, project office, liaison office or other place of business in India for the purpose of practicing legal profession. Accordingly, AD Category – I banks are directed not to grant any approval to any branch office, project office, liaison office or other place of business in India under FEMA for the purpose of practicing legal profession in India. Further, they shall bring to the notice of the Reserve Bank in case any such violation of the provisions of the Advocates Act comes to their notice

## Extension of the validity period for Liaison Office

1. A person resident outside India may establish a liaison office for a period of three years.
2. The non-resident entity may apply to the Authorised Dealer Category-I bank concerned for extension of the validity period of approval, and upon receipt of such an application, the Authorised Dealer Category-I bank concerned may extend the validity period of approval for a period of three years from the date of expiry of the original approval / extension granted, subject to such directions issued by the Reserve Bank in this regard.
3. The application for extension of the validity period of the liaison office of banks and entities engaged in insurance business has to be directly submitted to the Department of Banking Regulation (DBR), Reserve Bank and the Insurance Regulatory and Development Authority (IRDA) respectively.
4. Entities engaged in construction and development sectors and which are Non-Banking Finance Companies are permitted to open a Liaison Office for two years only. No further extension would be considered for liaison offices of entities which are Non-Banking Finance Companies and those engaged in construction and development sectors (excluding infrastructure development companies). Upon expiry of the validity period, the offices shall have to either close down or be converted into a Joint Venture / Wholly Owned Subsidiary in conformity with the extant Foreign Direct Investment policy.

## PROJECT OFFICE

Project office means a place of business in India to represent the interests of the foreign company executing a project in India but excludes a Liaison Office.

## Parameters of project office

A foreign company may open project office/s in India provided it has secured from an Indian company, a contract to execute a project in India, and

(i) the project is funded directly by inward remittance from abroad; or
(ii) project is funded by a bilateral or multilateral International Financing Agency; or
(iii) the project has been cleared by an appropriate authority; or
(iv) a company or entity in India awarding the contract has been granted term loan by a Public Financial Institution or a bank in India for the Project.

A person from any country other than Pakistan who has been awarded a contract for a project by a Government authority/ Public Sector Undertaking may open a bank account with an Authorised Dealer Category-I bank without any prior approval from the Reserve Bank.

## Cases in which RBI Approval is required for Setting up BO, PO and LO in India

- The applicant is a citizen of or is registered/incorporated in Pakistan;
- The applicant is a citizen of or is registered/incorporated in Bangladesh, Sri Lanka, Afghanistan, Iran, China, Hong Kong or Macau and the application is for opening a BO/LO/PO in Jammu and Kashmir, North East region and Andaman and Nicobar Islands;
- The principal business of the applicant falls in the four sectors namely Defence, Telecom, Private Security and Information and Broadcasting;
- The applicant is a Non-Government Organisation (NGO), Non-Profit Organisation, Body/ Agency/ Department of a foreign government.

## Master Direction - Establishment of Branch Office (BO) / Liaison Office (LO) / Project Office (PO) in India by foreign entities

A Branch Office can be established by a body incorporated outside India, including a firm or association of persons, involved in manufacturing or trading activities. The process of setting up is an easy one with minimal compliance requirements. The permission to set-up a BO has to be obtained by the RBI under the FEMA, 1999 provisions. RBI provides guidelines to be followed for establishing a BO; the former also reserves the right to reject an application on the non-fulfilment of the same. The Applications are to be made in form FNC and are considered by the RBI under two routes determined by the degree of Foreign Direct Investment (FDI):

- Reserve Bank Route: If the principal business of the foreign company falls under sectors where 100% FDI is permissible under the automatic route, applications will be processed by RBI.
- The Government Route: If the principal business of the foreign parent company does not fall under the 100 sectors where 100% FDI is permissible under the automatic route or the application is from companies that are Non- Profit Organisations/ Non – Government Organisations / Government Bodies/ Departments, such applications will be considered by the RBI in consultation with the Ministry of Finance, Government of India.

Additionally, the RBI will also consider the following criteria while sanctioning the Liaison office/ Branch office of a parent company. The RBI has a few other considerations:

- Track Record: For a BO a company will require a profit making track record in the in the immediately preceding five financial years in the home country.
- Net Worth: "a total of paid-up capital and free reserves, less intangible assets as per the latest Audited Balance Sheet or Account Statement Certified by a Certified Public Accountant or any Registered Accounts Practitioner". The net worth has to be equal to or more than USD 100,000.

Applications from foreign companies (a body corporate incorporated outside India, including a firm or other association of individuals) for establishing BO/ LO/ PO in India shall be considered by the AD Category-I bank as per the guidelines given by Reserve Bank of India (RBI). If the principal business of the entity resident outside India falls under sectors where 100 percent Foreign Direct Investment (FDI) is allowed in terms Foreign Exchange Management (Transfer or issue of Security by a Person Resident outside India) Regulations, 2000, as amended from time to time, and the entity seeks to open a BO/LO/PO, the AD Category-I bank may consider such applications under the delegated powers.

An application from a foreign for opening of a BO/LO/PO in India shall require prior approval of Reserve Bank of India and shall be forwarded by the AD Category-I bank to the General Manager, Reserve Bank of India, Central Office Cell, Foreign Exchange Department, 6, Sansad Marg, New Delhi - 110 001 who shall process the applications in consultation with the Government of India, in the following cases:

- The applicant is a citizen of or is registered/incorporated in Pakistan;
- The applicant is a citizen of or is registered/incorporated in Bangladesh, Sri Lanka, Afghanistan, Iran, China, Hong Kong or Macau and the application is for opening a BO/LO/PO in Jammu and Kashmir, North East region and Andaman and Nicobar Islands;
- The principal business of the applicant falls in the four sectors namely Defence, Telecom, Private Security and Information and Broadcasting. However, prior approval of Reserve Bank of India shall not be required in cases where Government approval or license/permission by the concerned Ministry/ Regulator has already been granted. Further, in the case of proposal for opening a PO relating to defence sector, no separate reference or approval of Government of India shall be required if the said non-resident applicant has been awarded a contract by/ entered into an agreement with Ministry of Defence or Service Headquarters or Defence Public Sector Undertakings. The term "permission" used in the Government of India Notification dated January 21, 2019 does not include general permission, if any, available under Foreign Direct Investment in the automatic route, in respect of the above four sectors;
- The applicant is a Non-Government Organisation (NGO), Non-Profit Organisation, Body/ Agency/ Department of a foreign government. However, if such entity is engaged, partly or wholly, in any of the activities covered under Foreign Contribution (Regulation) Act, 2010 (FCRA), they shall obtain a certificate of registration under the said Act and shall not seek permission under FEMA 22(R).

The application by the foreign company has to be made through a designated AD Category-I bank to the General Manager of the Foreign Exchange Department of RBI. Some prescribed documents have to be attached with the application. The RBI Master Circular of 2016 provides two of the documents that have to be attached:

1. English version of the Certificate of Incorporation / Registration or Memorandum & Articles of Association attested by Indian Embassy / Notary Public in the Country of Registration.
2. Latest Audited Balance Sheet of the applicant entity."

Even if applications do not satisfy the criteria if an agent files them on behalf of a parent company, that parent company ought to satisfy the criteria. The AD-I Category bank involved in the process will conduct due diligence on the Applicant in the following areas- "background, antecedents of the promoter, nature and location of activity, sources of funds, etc.", along with compliance of the Know Your Customer (KYC) norms.

The BO hence, once approved by the RBI, will be allotted a Unique Identification Number (UIN). Once the offices have been set up, the BO must also obtain a Permanent Account Number (PAN) from the Income Tax Authorities. This should be reported in the Annual Activity Certificate (AAC) that the BO is required to present at the end of each ear to show that the activities are undertaking in the permitted categories only.

Section 382 of the Companies Act, 2013, states that the company has to 'conspicuously' exhibit outside the office, the company's name and the specify country it was incorporated in. The name must be in English Language and in the local language of the area where the office is set-up. If the members of the company have limited liability, then the same has to be specified with the name of the company outside the office and also mentioned in all the

broachers, prospectus and any other circulars generated by the company. The Act also provides for the registration of the prospectus of the company with the registrar before it circulates and spreads any information about the issuance of securities by the company.

## Procedure for Establishment of BO/LO/PO

Following steps are followed for establishing the Branch Office/ Liaison Office/ Project Office of Foreign Company:

1. **Submission of Form FNC:** The application for establishing BO / LO/ PO in India may be submitted by the non-resident entity in Form FNC to a designated AD Category - I bank (i.e., an AD Category – I bank identified by the applicant with whom they intend to pursue banking relations) along with the prescribed documents and the LOC, wherever applicable.

   Following are the prescribed documents:

   (a) Copy of the Certificate of Incorporation / Registration; Memorandum of Association and Articles of Association attested by the Notary Public in the country of registration.

   [If the original Certificate is in a language other than in English, the same may be translated into English and notarized as above and cross verified/attested by the Indian Embassy/ Consulate in the home country].

   (b) Audited Balance sheet of the applicant company for the last three/ five years in case of branch office/ liaison office respectively.

   [If the applicants' home country laws/regulations do not insist on auditing of accounts, an Account Statement certified by a Certified Public Accountant (CPA) or any Registered Accounts Practitioner by any name, clearly showing the net worth may be submitted].

   (c) Bankers' Report from the applicant's banker in the host country / country of registration showing the number of years the applicant has had banking relations with that bank.

   (d) Power of Attorney in favour of signatory of Form FNC in case the Head of the overseas entity is not signing the Form FNC.

   The AD Category-I bank shall after exercising due diligence in respect of the applicant's background, and satisfying itself as regards adherence to the eligibility criteria for establishing BO/LO/PO, antecedents of the promoter, nature and location of activity of the applicant, sources of funds, etc., and compliance with the extant KYC norms grant approval to the foreign entity for establishing BO/LO/PO in India.

2. **Allotment of Unique Identification Number (UIN):** However, before issuing the approval letter to the applicant, the AD Category-I bank shall forward a copy of the Form FNC along with the details of the approval proposed to be granted by it to the General Manager, Reserve Bank of India, CO Cell, New Delhi, for allotment of Unique Identification Number (UIN) to each BO/ LO.

3. **Issue of Approval letter:** After receipt of the UIN from the Reserve Bank, the AD Category-I bank shall issue the approval letter to the non-resident entity for establishing BO/LO in India. This is in order to enable the Reserve Bank to keep, maintain and upload up-to-date list of all foreign entities which have been granted permission for establishing BO/LO in India, on its website.
4. **Intimation to Designated AD Category I bank:** An applicant that has received permission for setting up of a BO/LO/PO shall inform the designated AD Category I bank as to the date on which the BO/LO/ PO has been set up. The AD Category I bank in turn shall inform Reserve Bank accordingly. In case an approval granted by the AD bank has either been surrendered by the applicant or has expired without any BO/LO/PO being set up, the AD Category I bank shall inform RBI accordingly.
5. **Extension for setting up office:** The approval granted by the AD Category I bank should include a proviso to the effect that in case the BO/LO/ PO for which approval has been granted is not opened within six months from the date of the approval letter, the approval shall lapse. In cases where the nonresident entity is not able to open the office within the stipulated time frame due to reasons beyond its control, the AD Category-I bank may consider granting extension of time for a further period of six months for setting up the office. Any further extension of time shall require the prior approval of Reserve Bank of India in this regard.
6. **BO/LO by foreign banks and insurance companies:** All applications for establishing a BO/LO in India by foreign banks and insurance companies will be directly received and examined by the Department of Banking Regulation (DBR), Reserve Bank of India, Central Office and the Insurance Regulatory and Development Authority (IRDA), respectively. No UIN for such representative offices is required from the Foreign Exchange Department, Reserve Bank of India.

## Opening of bank account by BO/LO/PO

I. An LO may approach the designated AD Category I Bank in India to open an account to receive remittances from its Head Office outside India. It may be noted that an LO shall not maintain more than one bank account at any given time without the prior permission of Reserve Bank of India. The permitted Credits and Debits to the account shall be:

(a) Credits:

1. Funds received from Head Office through normal banking channels for meeting the expenses of the office.
2. Refund of security deposits paid from LO's account or directly by the Head Office through normal banking channels.
3. Refund of taxes, duties etc., received from tax authorities, paid from LO's bank account.
4. Sale proceeds of assets of the LO.

(b) Debits: Only for meeting the local expenses of the office.

A BO may approach any AD Category I Bank in India to open an account for its operations in India. Credits to the account should represent the funds received from Head Office through normal banking channels for meeting the expenses of the office and any

legitimate receivables arising in the process of its business operations. Debits to this account shall be for the expenses incurred by the BO and towards remittance of profit/ winding up proceeds.

II. Any foreign entity except an entity from Pakistan who has been awarded a contract for a project by the Government authority/Public Sector Undertakings or are permitted by the AD to operate in India may open a bank account without any prior approval of the Reserve Bank. An entity from Pakistan shall need prior approval of Reserve Bank of India to open a bank account for its project office in India.

III. AD Category – I banks can open non-interest bearing foreign currency account for POs in India subject to the following:

(a) The PO has been established in India, with the general / specific permission of Reserve Bank of India, having the requisite approval from the concerned Project Sanctioning Authority concerned as per FEM (Establishment in India of Branch Office or a Project Office or any other Place of Business Regulations, 2016).

(b) The contract governing the project specifically provides for payment in foreign currency.

(c) Each PO can open two foreign currency accounts, usually one denominated in USD and other in home currency of the project awardee, provided both are maintained with the same AD Category–I bank.

(d) The permissible debits to the account shall be payment of project related expenditure and credits shall be foreign currency receipts from the Project Sanctioning Authority and remittances from parent/ Group Company abroad or bilateral / multilateral international financing agency.

(e) The responsibility of ensuring that only the approved debits and credits are allowed in the foreign currency account shall rest solely with the AD Category I bank. Further, the accounts shall be subject to 100 per cent scrutiny by the Concurrent Auditor of the respective AD Category–I bank.

(f) The foreign currency accounts have to be closed at the completion of the project.

## Annual Activity Certificate by BO/LO/PO

(i) The Annual Activity Certificate (AAC) as at the end of March 31 each year along with the required documents needs to be submitted by the following:

(a) In case of a sole BO/ LO/PO, by the BO/LO/PO concerned;

(b) In case of multiple BOs / LOs, a combined AAC in respect of all the offices in India by the nodal office of the BOs / LOs.

The LO/BO needs to submit the AAC to the designated AD Category -I bank as well as Director General of Income Tax (International Taxation), New Delhi whereas the PO needs to submit the AAC only to the designated AD Category -I bank.

(ii) The designated AD Category - I bank shall scrutinize the AACs and ensure that the activities undertaken by the BO/LO are being carried out in accordance with the terms and conditions of the approval given.

In the event of any adverse findings reported by the auditor or noticed by the designated AD Category -I bank, the same should immediately be reported to the General Manager, Reserve Bank of India, CO Cell, New Delhi, along with the copy of the AAC and their comments thereon.

## Extension of validity period of the approval of LO and PO

(i) Requests for extension of time for LOs may be submitted before the expiry of the validity of the approval, to the AD Category-I bank concerned under whose jurisdiction the LO/nodal office is located. The designated AD Category - I bank may extend the validity period of LO/s for a period of 3 years from the date of expiry of the original approval/ extension granted if the applicant has complied with the following conditions and the application is otherwise in order:

(a) The LO should have submitted the Annual Activity Certificates for the previous years; and

(b) The account of the LO maintained with the designated AD Category-I bank is being operated in accordance with the terms and conditions stipulated in the approval letter.

Such extension has to be granted, as expeditiously as possible as and in any case not later than one month from the receipt of the request under intimation to the General Manager, Reserve Bank of India, CO Cell, New Delhi quoting the reference number of the original approval letter and the UIN. Reserve Bank shall update the information on its website immediately.

(ii) Further, entities engaged in construction and development sectors and Non- Banking Finance Companies are permitted to open a liaison office for two years only. No further extension would be considered for liaison offices of entities which are Non- Banking Finance Companies and those engaged in construction and development sectors (excluding infrastructure development companies).

Upon expiry of the validity period, the offices shall have to either close down or be converted into a Joint Venture / Wholly Owned Subsidiary in conformity with the extant Foreign Direct Investment policy.

## Registration with police authorities

Applicants from Bangladesh, Sri Lanka, Afghanistan, Iran, China, Hong Kong, Macau or Pakistan desirous of opening BO/LO/PO in India shall have to register with the state police authorities. Copy of approval letter for 'persons' from these countries shall be marked by the AD Category-I bank to the Ministry of Home Affairs, Internal Security Division-I, Government of India, New Delhi for necessary action and record.

## Application for additional offices and activities

(i) Requests for establishing additional BOs / LOs may be submitted to the AD Category-I bank in a fresh FNC form. However, the documents mentioned in form FNC need not be resubmitted, if there are no changes to the documents already submitted earlier.

(a) If the number of offices exceeds 4 (i.e. one BO / LO in each zone viz; East, West, North and South), the applicant has to justify the need for additional office/s and it shall require prior approval of RBI.

(b) The applicant may identify one of its offices in India as the Nodal Office, which will coordinate the activities of all of its offices in India.

(c) Whenever the existing BO/LO is shifting to another city in India, prior approval from the AD Category-I bank is required. However, no permission is required if the LO/BO is shifted to another place in the same city subject to the condition that the new address is intimated to the designated AD Category-I bank. Changes in the postal address may be intimated to the CO Cell, New Delhi by the AD Category-I bank at the earliest.

(ii) Requests for undertaking activities in addition to what has been permitted initially (Annex C) by Reserve Bank of India / AD Category-I bank may be submitted by the applicant to the Reserve Bank through the designated AD Category -I bank justifying the need.

## Extension of Fund and Non-Fund Based Facilities

AD Category-I bank may be based on their business prudence, Board approved policy and compliance to extant rules/ regulations stipulated by DBR, RBI extend fund/non-fund based facilities to BOs/POs only.

## Closure of BO/PO/LO

1. **Submission of request for closure:** Requests for closure of the BO / LO/ PO and allowing the remittance of winding up proceeds of BO / LO/ PO may be submitted to the designated AD Category - I bank by the BO/ LO/ PO or their nodal office, as the case may be. The application for winding up may be submitted along with the following documents:

(a) Copy of the Reserve Bank's/AD Category-I bank's approval for establishing the BO/ LO/ PO.

(b) Auditor's certificate:

(i) indicating the manner in which the remittable amount has been arrived at and supported by a statement of assets and liabilities of the applicant and indicating the manner of disposal of assets;

(ii) confirming that all liabilities in India including arrears of gratuity and other benefits to employees, etc. of the office have been either fully met or adequately provided for; and

(iii) confirming that no income accruing from sources outside India (including proceeds of exports) has remained unrepatriated to India.

(c) Confirmation from the applicant/parent company that no legal proceedings in any Court in India are pending against the BO / LO/ PO and there is no legal impediment to the remittance.

(d) A report from the Registrar of Companies regarding compliance with the provisions of the Companies Act, 2013, in case of winding up of the BO /LO in India, wherever applicable.

(e) The designated AD Category - I banks has to ensure that the BO / LO/ PO had filed their respective AACs.

(f) Any other document/s, specified by Reserve Bank of India / AD Category- I bank while granting approval.

2. **Remittance of winding up proceeds:** Designated AD Category-I bank may allow remittance of winding up proceeds in respect of offices of banks and insurance companies, after obtaining copies of permission of closure from the sectoral regulators along with the documents mentioned above.

# FOREIGN EXCHANGE MANAGEMENT ACT, 1999

Section 6 of the Foreign Exchange Management Act, 1999 provides powers to the Reserve Bank to specify, in consultation with the Government of India, the classes of permissible capital account transactions and limits up to which foreign exchange is admissible for such transactions. Section 6(3) of the aforesaid Act provides powers to the Reserve Bank to prohibit, restrict or regulate various transactions referred to in the sub-clauses of that sub-section, by making Regulations.

In exercise of the above powers conferred under the Act, the Reserve Bank, with effect from August 22, 2022, has combined erstwhile FEMA (Transfer or Issue of Foreign Security) Regulations, 2004 ('erstwhile ODI regulations') and FEMA (Acquisition and Transfer of immovable property outside India) Regulations, 2015 into FEMA (Overseas Investment) Rules, 2022 ('OI Rules') and FEMA (Overseas Investment) Regulations, 2022 ('OI Regulations') and the erstwhile regulations stand superseded.

RBI has also issued the compiled FEMA (Overseas Investment) Directions, 2022 ('OI Directions') covering the OI Rules and OI Regulations grouping the requirements under three categories viz. General provisions, Specific provisions and Other operational instructions to the AD Banks. It also provides for certain compliance requirements from the erstwhile ODI Master Directions, which are not covered in OI Rules or Regulations.

A significant step has been taken with operationalisation of a new Overseas Investment regime. The new regime simplifies the existing framework for overseas investment by persons resident in India to cover wider economic activity and significantly reduces the need for seeking specific approvals. This will reduce the compliance burden and associated compliance costs.

The changes brought about through the new rules and regulations are summarised below:

(i) enhanced clarity with respect to various definitions;
(ii) introduction of the concept of "strategic sector";
(iii) dispensing with the requirement of approval for:
    (a) deferred payment of consideration;
    (b) investment/ disinvestment by persons resident in India under investigation by any investigative agency/ regulatory body;
    (c) issuance of corporate guarantees to or on behalf of second or subsequent level step down subsidiary (SDS);
    (d) write-off on account of disinvestment;
(iv) introduction of "Late Submission Fee (LSF)" for reporting delays.

## OI Rules v/s OI Regulations

OI Rules provides the regulatory framework for making of overseas investment covering the permissions, conditions for making overseas investment, restrictions from making Overseas Direct Investment ('ODI'), pricing guidelines, transfer, liquidation and restructuring of ODI. While the OI Rules have been framed by CG, however, the same will be administered by the RBI as per Rule 3(1).

OI Regulations, on the other hand, provides only the operational part covering conditions for undertaking Financial Commitment ('FC'), other than by investment in equity capital, consideration in case of acquisition or transfer of equity capital of a Foreign Entity ('FE'), mode of payment, obligations of Persons Resident in India ('PRII'), reporting requirements, consequence of delay in reporting and restrictions on further FC/ transfer.

## OVERSEAS INVESTMENT

Under the erstwhile ODI regulations, effective till August 21, 2022, there was a concept of direct investment outside India in JV and WOS that excluded portfolio investment and FC.

OI Rules combine the two to define Financial Commitment and separately define the term Overseas Portfolio Investment ('OPI').

"Financial commitment" by a person resident in India means the aggregate amount of investment by way of ODI, debt other than Overseas Portfolio Investment (OPI) and non-fund based facility or facilities extended by it to all foreign entities. An Indian entity may lend or invest in any debt instruments issued by a foreign entity or extend non-fund based commitment to or on behalf of a foreign entity, including overseas Step down Subsidiaries of such Indian entity, subject to the following conditions:

(a) the Indian entity is eligible to make ODI;
(b) the Indian entity has made ODI in the foreign entity;
(c) the Indian entity has acquired control in the foreign entity on or before the date of making such financial commitment.

"Overseas Investment" or "OI" means financial commitment and Overseas Portfolio Investment by a person resident in India;

$$\mathbf{OI = FC + OPI}$$

Overseas Investment (or financial commitment) can be made under two routes viz.

(i) Automatic Route and
(ii) Approval Route subject to the provisions contained in the OI Rules, OI Regulations and OI Directions.

The classification as ODI depends on the nature of instruments in which investment is made, the nature of the entity in which investment is made and whether control has been acquired or not.

## ELIGIBILITY (ENTITIES ARE REFERRED TO AS "INDIAN ENTITY")

The extant concept of Indian party (IP) where all the investors from India in a foreign entity were together considered as IP, has been substituted under the new regime with the concept of Indian entity where each investor entity shall be separately considered as an Indian entity. Indian entity shall mean:

- a Company defined under the Companies Act, 2013 or
- a Body Corporate incorporated by any law for the time being in force or
- a Limited Liability Partnership formed under the Limited Liability Partnership Act, 2008 or
- a Partnership Firm registered under the Indian Partnership Act, 1932.

The extant concept of Joint Venture (JV) and Wholly Owned Subsidiary (WOS) is substituted under the new regime with the concept of foreign entity, which means an entity formed or registered or incorporated outside India, including in International Financial Services Centre (IFSC) in India, that has limited liability. 'Limited liability' would mean a structure such as a limited liability company, limited liability partnership, etc. where the liability of the person resident in India is clear and limited.

In case of a foreign entity being an investment fund or vehicle, duly regulated by the regulator for the financial sector in the host jurisdiction and set up as a trust outside India, the liability of the person resident in India shall be clear and limited not exceeding the interest or contribution in the fund in any manner. Further, the trustee of such fund shall be a person resident outside India.

## NON-APPLICABILITY

- Investments made by a financial institution in an IFSC. The OI Rules prescribes the conditions for investment in IFSC vide Schedule V to OI Rules;
- Acquisition or transfer of any investment outside India made out of Resident Foreign Currency Account;
- Acquisition or transfer of any investment outside India made out of foreign currency resources held outside India by a person who is employed in India for a specific duration irrespective of length thereof or for a specific job or assignment, duration of which does not exceed three years; or
- Acquisition or transfer of any investment outside India made in accordance with Section 6(4) of FEMA Act i.e. where the investment in the foreign security or any immovable property situated outside India was acquired when the person was resident outside India or inherited from a person who was resident outside India.

The erstwhile ODI Master Directions provided general permission for purchase/acquisition of securities by a person resident in India as bonus shares on existing holding of foreign currency shares and also for rights shares against holding of shares in accordance with provisions of law. The OI Rules covers the same under Rule 7.

## PROHIBITIONS

1. No person resident in India shall make ODI in a foreign entity engaged in –
   - real estate activity;
   - gambling in any form; and
   - dealing with financial products linked to the Indian rupee without specific approval of the Reserve Bank.

   The expression "real estate activity" means buying and selling of real estate or trading in Transferable Development Rights but does not include the development of townships, construction of residential or commercial premises, roads or bridges for selling or leasing.

2. Any ODI in start-ups recognised under the laws of the host country or host jurisdiction as the case maybe, shall be made by an Indian entity only from the internal accruals whether from the Indian entity or group or associate companies in India and in case of resident individuals, from own funds of such an individual.
3. No person resident in India shall make financial commitment in a foreign entity that has invested or invests into India, at the time of making such financial commitment or at any time thereafter, either directly or indirectly, resulting in a structure with more than two layers of subsidiaries:

   Provided that such restriction shall not apply to the following classes of companies mentioned in Rule 2 of the Companies (Restriction on Number of Layers) Rules, 2017 as may be amended from time to time, namely –

   (a) a banking company as defined in the Banking Regulation Act, 1949;
   (b) a non-banking financial company as defined in the Reserve Bank of India Act, 1934 which is registered with the Reserve Bank and considered as systematically important non-banking financial company by the Reserve Bank;
   (c) an insurance company being a company which carries on the business of insurance in accordance with provisions of the Insurance Act, 1938 and the Insurance Regulatory and Development Authority Act, 1999; and
   (d) a Government company referred to in the Companies Act, 2013.

## AUTOMATIC ROUTE

Rule 9 of OI Rules, 2022 lays down the general rule for overseas investments under the automatic route. It states that subject to prescribed limits and conditions, any overseas investment by a person resident in India shall be made in a foreign entity engaged in bona-fide business activity, directly or through step-down subsidiary or the special-purpose vehicle.

Step-down subsidiary, in respect of a foreign entity, has been defined as an entity in which the foreign entity has control. It is also provided that for investments made through a step-down subsidiary to qualify as overseas investment and be permissible under OI Rules, the step-down subsidiary shall comply with the structural requirements of a foreign entity, i.e. it shall have limited liability. Earlier, overseas direct investments (ODI) was only allowed in an entity engaged in bona-fide business activity either directly, or through one layer of SPV.

In this context, the new Rule seems to be expansive in as much as it allows overseas investment into an entity engaged in bona-fide business, including through multiple layers of step-down subsidiary or special purpose vehicle. In other words, it may now be possible to invest in a foreign holding company (SPV) which has one of more layers of foreign subsidiaries as long as the ultimate foreign subsidiary is engaged in a bona fide business activity.

'Bona-fide business activity' has been defined as any business activity permissible under any law in force in India and the host country / host jurisdiction. Hence, the business activity must be permitted under the laws of India as well as the host country for it to qualify as 'bona-fide' business activity.

The definition of the term bona-fide business activity is a welcome move as it brings about a certain level of clarity. Having said that, confusion still prevails in terms of what is meant by permitted under laws of India (and also the laws of the host country). There may be activities, such as gambling, which are state subjects and may be permitted in some states whilst not being permitted in others. Additionally, whether a pure holding company will qualify as a bona-fide business activity also remains a question due to the manner in which the definition has been worded.

Further, keeping in mind that control is defined to mean the right to appoint majority of the directors or control the management or policy decisions, and ODI means the acquisition of unlisted equity capital, subscription to MoA of a foreign entity, investment in 10% or more of listed securities, or investment in less than 10% of listed securities with control, it may be possible to argue that control is possible without infusion of capital. Accordingly, where a foreign entity is set up without any outward remittance of cash (for example in Delaware where a company can be incorporated without capital contribution), and the Indian resident has control of such entity, the transaction should qualify as an ODI. Similarly, a gift of controlling shares of a foreign entity from a non-resident to resident may also result in the resident having made ODI into the foreign entity.

## APPROVAL ROUTE

Rule 9 of OI Rules, 2022 also provides that overseas investment under the automatic route, shall not be made into a company incorporated in Pakistan (including by way of swap of securities) or such other country as may be decided by the Central Government, from time to time.

The OI Rules provide for investments that will require prior approval of CG, RBI and NOC from lender banks/ regulatory bodies etc. The Erstwhile ODI Regulations only mandated prior approval of RBI in case eligibility conditions stipulated were not met by the Indian party or resident individual. The OI Rules read with the OI Directions provide that:

**Approval from Central Government:** The applications for overseas investments (including financial commitment) in Pakistan / other countries as may be restricted by the Central Government from time to time or in strategic sectors / specific geographies beyond the prescribed limits, shall be made to the Central Government through the RBI. As such, the applications shall be forwarded by the AD banks to the RBI for onward submission to the Central Government.

**Approval from Reserve Bank:** As set out under the Erstwhile Regime, the OI Rules also provide that financial commitment by an Indian entity, exceeding USD 1 billion (or its equivalent) in a financial year shall require prior approval from the RBI even when the total financial commitment of the Indian entity is within the eligible limit.

In essence, the Rule provides that approval with respect to investment in restricted geography / sector has to be obtained from the Central Government, whereas approval for investments beyond the monetary limit has to be obtained from the RBI.

The erstwhile ODI Master Directions prohibited an Indian Party from making direct investment in countries identified by Financial Action Task Force ('FATF') as 'non co-operative countries and territories' as per the list available on FATF website or as notified by RBI. The OI Rules do not expressly provide for such prohibition, however, empowers the CG to advise countries or jurisdictions where overseas investment shall not be made.

Further, as provided in the erstwhile ODI Master Directions for prior approval of RBI for any FC exceeding USD 1 billion or its equivalent in a financial year even when the total FC of the Indian Party was within the eligible limit under automatic route (i.e. within 400% of the net worth as per the last audited balance sheet), the requirement continues under the current regime as well. Procedure for seeking approval of RBI has been provided in the OI Directions.

Approval requirement has been dispensed for deferred payment of consideration, investment/ disinvestment by PRII under investigation by any investigative agency/ regulatory body, issuance of corporate guarantee to or on behalf of second or subsequent step down subsidiary and write-off on account of disinvestment.

## No Objection Certificate

Rule 10 provides that if any person resident in India who –

(i) has an account appearing as a non-performing asset (NPA); or
(ii) is classified as a willful defaulter by any bank; or
(iii) is under investigation by a financial services regulator or by investigative agencies in India such as the Central Bureau of Investigation (CBI), Directorate of Enforcement ("ED") or Serious Frauds Investigation Office ("SFIO") – shall obtain a No Objection Certificate (NOC) from the concerned bank, regulator or investigative agency, as the case may be, for making any financial commitment or undertaking any divestment under the OI Rules.

Given that this requirement is only for financial commitment, it seems to not be applicable for making OPI investments.

It is provided that if the bank, regulator or investigative authority, as the case may be, fails to furnish the NOC within 60 days from the receipt of application, an NOC may be presumed to have been obtained. The concept of 'deemed consent' in case of NOCs upon expiry of sixty days from the date of application may be a cause of concern for the lenders/ banks/ regulatory agencies etc.

Further, the OI Directions clarify that where an Indian entity has already issued a guarantee in accordance with the OI Rules before an investigation has begun or account is classified as an NPA/ willful defaulter and is subsequently required to honour such guarantee, such remittance will not constitute fresh financial commitment and hence NOC shall not be required.

## METHOD OF FUNDING

The mode of payment by a person resident in India for making overseas investment shall be in accordance with regulation 8 of the OI Regulations. A person resident in India making Overseas Investment may make payment –

(i) by remittance made through banking channels;
(ii) from funds held in an account maintained in accordance with the provisions of the Act;
(iii) by swap of securities;
(iv) by using the proceeds of American Depository Receipts or Global Depositary Receipts or stock-swap of such receipts or external commercial borrowings raised in accordance with the provisions of the Act and the rules and regulations made thereunder for making ODI or financial commitment by way of debt by an Indian entity.

It is further provided in the OI Directions that:

(a) Overseas investment by way of cash is not permitted.
(b) In terms of Regulation 5(B) of Notification No. FEMA 10(R)/2015-RB, namely, Foreign Exchange Management (Foreign Currency Accounts by a resident in India) Regulations, 2015, an Indian entity can make remittances to its office/branch outside India only for the purpose of normal business operations of such branch or office. Accordingly, no remittance shall be made by any Indian entity to its branch/ office outside India for making any overseas investment.
(c) A person resident in India shall not make any payment on behalf of any foreign entity other than by way of financial commitment as permitted under the OI Rules/Regulations.
(d) Any investment/financial commitment in Nepal and Bhutan shall be done in a manner as provided in Notification No. FEMA 14(R)/2016-RB, namely, Foreign Exchange Management (Manner of Receipt and Payment) Regulations, 2016. All dues receivable on investments (or financial commitment) made in freely convertible currencies, as well as their sale/winding up proceeds are required to be repatriated to India in freely convertible currencies only.

## FOREIGN DIRECT INVESTMENT POLICY

The Department for Promotion of Industry and Internal Trade (DPIIT) is the nodal Department for formulation of the policy of the Government on Foreign Direct Investment (FDI). It is also responsible for maintenance and management of data on inward FDI into India, based upon the remittances reported by the Reserve Bank of India. The FDI policy is reviewed on an ongoing basis, with a view to making it more investor-friendly. With a view to attracting higher levels of FDI, Government has put in place a liberal policy on FDI, under which FDI up to 100% is permitted under the automatic route in most sectors/activities. Significant changes have been made in the FDI Policy regime in recent times to ensure that India remains an increasingly attractive investment destination.

The DPIIT plays an active role in the liberalization and rationalization of the FDI policy and has been constructively engaged in extensive stakeholder consultations on various aspects of the FDI Policy.

The Government has put in place a policy framework on FDI, which is transparent, predictable and easily comprehensible. This framework is embodied in the Circular on Consolidated FDI Policy, which may be updated on an annual basis, to capture and keep pace with the regulatory changes, effected in the interregnum. The DPIIT, Ministry of Commerce & Industry, Government of India makes policy pronouncements on FDI through Consolidated FDI Policy Circular/Press Notes/Press Releases which are notified by the Department of Economic Affairs (DEA), Ministry of Finance, Government of India as amendments to the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 under the FEMA, 1999.

## Reporting requirements

The OI Regulations provide for various reporting requirements for FC and OPI including in case of disinvestment and restructuring. Reporting is very crucial as the OI Rules provide for prohibition on further FC or transfer to continue until any delay in reporting is regularized with payment of Late Submission Fees ('LSF') for an amount and in the manner as provided in the OI Directions. LSF amount is levied per return and the maximum amount for LSF will be limited to 100% of amount involved in the delayed reporting. The erstwhile ODI regulations restricted only in case of non-filing of Form APR. The format of forms has been provided in the Master Directions on Reporting under FEMA Act. Incomplete filing will be considered as non-submission.

As per the OI Regulations, all reporting by a person resident in India, as specified, shall be made through the designated AD bank in the manner provided in this regulation and in the format provided by the Reserve Bank.

A person resident in India who has made ODI or making financial commitment or undertaking disinvestment in a foreign entity shall report the following, namely –

(a) financial commitment, whether it is reckoned towards the financial commitment limit or not, at the time of sending outward remittance or making a financial commitment, whichever is earlier;
(b) disinvestment within thirty days of receipt of disinvestment proceeds;
(c) restructuring within thirty days from the date of such restructuring.

A person resident in India other than a resident individual making any Overseas Portfolio Investment (OPI) or transferring such OPI by way of sale shall report such investment or transfer of investment within sixty days from the end of the half-year in which such investment or transfer is made as of September or March-end. In case of OPI by way of acquisition of shares or interest under Employee Stock Ownership Plan or Employee Benefits Scheme, the reporting shall be done by the office in India or branch of an overseas entity or a subsidiary in India of an overseas entity or the Indian entity in which the overseas entity has direct or indirect equity holding where the resident individual is an employee or director.

**Annual Performance Report (APR):** A person resident in India acquiring equity capital in a foreign entity which is reckoned as ODI, shall submit an APR with respect to each foreign entity every year by 31st December and where the accounting year of such foreign entity ends on 31st December, the APR shall be submitted by 31st December of the next year. No APR shall be required where–

(i) a person resident in India is holding less than 10 per cent. of the equity capital without control in the foreign entity and there is no other financial commitment other than by way of equity capital; or

(ii) a foreign entity is under liquidation.

An Indian entity which has made ODI shall submit an Annual Return on Foreign Liabilities and Assets within such time as may be decided by the Reserve Bank from time to time, to the Department of Statistics and Information Management, Reserve Bank of India.

## ISSUES IN CHOOSING LOCATION OUTSIDE INDIA

Choosing business location is depends on the entry barriers in the governing law as some of the countries provide easy access to the businesses such as Property transfer, Reliability of electricity, Labor market regulation, Trade regulation and costs, Court efficiency, Creditors' rights, Credit information, Shareholders' rights, Tax regulation, Foreign direct investment, Overall business regulatory environment. However, the same can be categories as under:

### Geographical Location of the business

- Infrastructure (ports, airports, storage, specific storage types – such as cold-storage, secure storage)
- Access (transportation of goods, materials and personnel)
- Relevance to supply-chain: raw material sourcing, processing, despatch of finished produce
- Availability of talent pool for productions (labour), services and management
- Risks: The outbreak of COVID-19 highlights the pitfalls of global interdependency and the challenge for global governance. Epidemics and pandemics do not just come and go, they impact the economy and society as well. One should consider threats to the organization due to pandemic and other risks such as earthquake, tsunami etc.

### Economic Aspects

- Ease of doing business: entering, establishing, restructuring and closing the business, visa availability
- Cost of doing business: return on investment computations vis-à-vis comparable locations
- Laws relating to labour and Quality of labour force; availability of labour force; unemployment rate; labour unions; attitudes towards work and labour turnover; motivation of workers and work force management
- Laws relating to taxation: investment allowances, subsidies, distribution of profits, repatriation of profits, withholding taxes, existence of double-taxation avoidance agreements, information sharing requirements such as FATCA, TRC, etc.

A complete picture of the local, regional, and state tax environment must be obtained in order to make certain that the business can operate profitably. In several areas of the country, states have made changes to their tax structures, and it is important to understand how these changes negatively or positively impact a company's project

- Incentives: Local, regional, and/or state economic development incentives available to help the company lower project costs. Incentives should never drive site selection decisions, but they are important to ensure the economic feasibility of the project.

**Political Aspects**

- Friendly country, MFN status
- Long-standing and established legislative precedents with companies going through regulatory recourse
- Their relations with nearing countries and neighbours and your country
- Regulatory environment: Impact of local, regional, and state governmental regulations on business and project. Critical issues such as building plan approvals, environmental permits, utility connection approvals, and waste disposal permits can have a significant financial and timing impact on a company's project.

**Social Aspects**

- Trade bodies, interaction between commercial entities of both nations
- Expatriate-friendliness of the nation for relocating key employee personnel.

**Technological Aspects**

- Intellectual property protection: create, maintain and extract IP at the location or provision thereof from another location to the nation with free entry and egress.
- Power, communication, telecom – availability, quality and cost issues like infrastructure, geography, time zone, political considerations/conditions, safety of investments, economic policy and stability of the country, culture and language have a critical bearing on the strategy for globalization. Value systems and institutions are also becoming increasingly important from a long term perspective, in order to have the support of stakeholders. Ultimately, any chosen business strategy has to be executed within the parameters of legal and regulatory compliances. At the same time, it is necessary to factor in global tax costs and plan to the possible extent within the framework of law.

# Setting up of a Business in New Zealand

**Regulator: New Zealand Companies Office**

After choosing business name, business structure, apply online for registration with the Companies Office including IRD number application (IRD number is a unique number issued by Inland Revenue), registration for GST and New Zealand Business Number (NZBN is a globally unique identifier available to all businesses in New Zealand). To file an online application to incorporate a company with the Company's office, you must have:

- A RealMe Login (RealMe® is a government authentication and identity verification service)
- an online services account with the Companies Register.

**Secure your business name**

i. **Register a domain name:** Get a web address. This is a low cost, quick and easy process. Entrepreneurs can visit Domain Name Commission's list of authorised registrars.

ii. **Reserve your company name:** To reserve a company name online, entrepreneurs can visit the New Zealand Companies Office Web site (www. companies.govt.nz). A new company's name must be unique and can be reserved for up to 20 working days with the Companies Office. To be incorporated under the Companies Act 1993, a company must have a name reserved by the Registrar of Companies, at least one share, at least one shareholder, at least one director, a registered office, and an address for service.

The applicant(s) can apply for company registration online by completing forms on company details and paying the registration fee.

To register the company online, you can either click on the link in the email sent, when your company name reservation is approved, or log in to your account or follow these steps:

1. Select 'My unfinished business'
2. Select 'My tasks'
3. Find the 'Complete Coy Application' task
4. Progress through each screen (Directors, Shareholders, Tax Registration), entering the requested information
5. Select how you want to pay your application fee
6. Select 'Review' to check the information you've provided and then 'Submit'.

When the application is processed, the founder(s) will receive a notification within a few minutes by email along with the appropriate director and shareholder consent forms, which are generated by the Companies Office. The applicant must then fax the signed director and shareholder consent forms within 20 working days, after which the application will expire. The certificate of incorporation will be issued via email in a few minutes when the last consent form is accepted.

Promoters can apply online for a company IRD (Inland Revenue Department) number and register for the GST (Good and Service Tax) at the same time as incorporating a company online with the New Zealand Companies Office. The list of the information needed when applying for a company IRD number and registering for GST is as follows:

- Contact details
- The date the company will begin employing

- The number of employees and contractors (including the number of employees that will have a student loan)
- IRD number – The IRD number of each Director and all individual shareholders that are NZ residents, Main Business Activity, Place of Business and Postal Address, Trading Name of the company (if different from the Business Name), Company Contact details, a Business Industry Description and Code, and whether or not the Fringe Benefit Tax for employees is applicable.
- GST number – GST accounting method, frequency of filing returns, business activity code, details of how you would like refunds to be paid, whether or not the company will be making tax exempt supplies, Business Industry Description and Code, and whether or not the company will be making imports/ exports and ACC uses the business activity code to calculate levies for personal injury cover and residual claims (www.businessdescription.co.nz).
- The New Zealand Business Number (NZBN) is a unique identifier for a business in New Zealand. NZBN links to the information others need in order to work with the Company, like a trading name, phone number or email. An NZBN makes it easier to carry on the business because the same information doesn't need to be repeated when dealing with new clients or on occurrence of any new event. In case of a company, an NZBN is automatically issued. Sole traders, self-employed people or partnerships can register for an NZBN online and it's free of cost.

iii. **Check for trademarks:** Get an initial assessment report from the Intellectual Property Office (IPONZ) before you invest in applying for a registered trade mark. This can be done by applying online for a search and preliminary advice (SPA) report on the IPONZ website. It's low cost, easy and it will be received within 5 days. We can also search the trade mark register for free.

Before registering, make sure the business name has been given the green light from IPONZ SPA check.

iv. **Regulatory Check:** Specific regulations might apply in the industry or region. For example, fair trading, consumer guarantees, privacy, health and safety, food licensing. Central and Local government regulations apply to the business must be checked.

Since July 1st 2008, it has been mandatory to file most documents with the Companies Office online. Starting in November 2014, clients had the ability to pay the incorporation prescribed fees using internet banking.

# Setting up of Business in Singapore

**Regulator: Accounting and Corporate Regulatory Authority (ACRA)**

**Registration online with ACRA including company name search and filing the company incorporation and tax number (GST)**

The Accounting and Corporate Regulatory Authority (ACRA) is the national regulator of business, public accountants and corporate service providers in Singapore. Incorporation is done through Bizfile+, an electronic filing system.

BizFile+ is ACRA's online filing and information retrieval system. It enables the public to access a suite of over 300 electronic services ranging from the submission of statutory documents, and to retrieve and purchase information pertaining to business entities registered with ACRA. Currently, BizFile+ handles more than 1 million transactions each year.

Since 2007, Bizfile platform (further enhanced to Bizfile+) has been providing one-stop business facilitation services to customers at the point of registration. These services include reserving domain names, goods and services tax (GST) registration, subscribing for the relevant e-newsletter and registering for e-service alerts on latest government procurement opportunities, activating Customs Account and application for a corporate bank account.

The process starts with new company name application. The application for approval and reservation of a company name is to be submitted online at www.bizfile.gov.sg . An application fee of SGD 15 is payable for each approved company name. Once the application is submitted, the applicant can select to either pay the fee and continue with the incorporation later, or to immediately proceed to incorporation application.

Name application can be approved within a few minutes from payment if the name is available. However, it may take between 14 working days to 2 months if the application needs to be referred to another agency for approval or review. The lodger can proceed to register the business immediately after the name application is approved.

Once a name has been approved, it will be reserved for 120 days.

As of 2nd June 2017, every newly incorporated business receives a free copy of its Business Profile upon the successful filling up of the incorporation forms and paying the incorporation fee. The processing time is about 15 minutes from the time of successful submission of all documents and all information, and the registration fee payable is SGD 300. The ACRA will issue a notice of incorporation via electronic mail to the law firm or professional firm engaged for the purposes of incorporation upon the successful incorporation of the company together with the registration number of the company.

The registration with the Inland Revenue Authority of Singapore (IRAS) for the goods and services tax (GST) when its annual taxable turnover exceeds SGD 1 million can be done using the same online forms.

**Key Notes:**

There are 7 types of companies which can be incorporated in Singapore. On submitting the company name application, the relevant company type must be specified. The available options are:

1. Exempt private company
2. Private company limited by shares

3. Public company limited by shares
4. Public company limited by guarantee
5. Unlimited private company
6. Unlimited exempt private company
7. Unlimited public company

The private limited company is governed by the Singapore Companies Act and must comply with its laws under ACRA and the Inland Revenue Authority of Singapore (IRAS). Designations include:

- Company name – Must be approved by the ACRA.
- Shareholders – Minimum of one.
- Directors – At least one director must reside in Singapore.
- Company Secretary – Also must be a Singapore resident.
- Paid-up capital – At least S$1
- Registered address – A physical office address is required

**Sign up for Employee Compensation Insurance at an insurance agency:**

Agency: Insurance Agency

Under Section 23(1) of the Work Injury Compensation Act (WICA), of Singapore, every employer shall insure and maintain insurance under one or more approved policies with an insurer against all liabilities which the company may incur under the provisions of this Act in respect of any employee employed by the company unless the Minister, by notification in the Gazette, waives the requirement of such insurance in relation to any employer. The purchase of Workman Injury Compensation Insurance (WICI) has been incorporated into ACRA's online registration process as of November 2017. Business owners can now apply for WICI from ACRA's online Bizfile+ system immediately after completing the online registration process. Time and cost may depend on the arrangement between the company and the insurance agency.

## Setting up of a Business in Hong Kong SAR, China

**Agency: Companies Registry**

**Choose a company name and obtain a certificate of incorporation and a business registration certificate**

A company name (which may be in English, traditional Chinese or both) can be searched online free of charge at the Companies Registry (www.icris.cr.gov.hk) or at the mobile website (www.mobile-cr.gov.hk). When an application is delivered online at the e-Registry, the applicant will be informed of the acceptability of the company name before he/she proceeds with the payment process.

If there is no existing company registered with the name chosen by the applicant, a certificate of incorporation and a business registration certificate will be issued upon the filing of an incorporation form signed by the founder member(s) (for companies limited by shares this is a Form NNC1), a copy of the articles of association and a Notice to Business Registration Office (IRBR1). The incorporation form contains comprehensive information on the address of the registered office and particulars of the first secretary and first directors of a company. Paper submissions for incorporation normally require approximately

4 working days for the certificates to be issued (excluding the day of submission of form NNC1).

With the implementation of the "e-Registry" in 2011, applicants can now complete the incorporation and business registration process by submitting electronic applications online to the Companies Registry (www.eregistry.gov.hk) or using the mobile application "CR eFiling". In straightforward cases, this enables registered users to complete the relevant procedures and download the electronic Certificate of Incorporation and Business Registration Certificate in less than a day. According to the performance pledge of the Companies Registry (at www.cr.gov.hk/en/ about/performance.htm), the service standard for applications for registration of local companies which are submitted electronically is one hour.

At the moment of incorporation, the company will also be automatically registered with the Inland Revenue Department for registration for tax purposes.

**Sign up Employee's Compensation Insurance and Mandatory Provident Fund (MPF) Schemes with a private company or a bank**

**Agency: Compensation Insurance and Mandatory Provident Fund (MPF) providers (banks/insurance firms)**

Pursuant to the Employees' Compensation Ordinance ("ECO"), an employer must take out insurance to cover liabilities for his employees (both full- and part-time) who experience accidents arising out of and in the course of employment, and resulting in injuries or fatalities.

In addition, under the Mandatory Provident Fund Schemes Ordinance, employers must enroll their regular employees (i.e. employees who are at least 18 but under 65 years of age and employed for 60 days or more) and where applicable, their casual employees (i.e. employees are at least 18 but under 65 years of age and employed in the construction or catering industry on a day-to-day basis or for a fixed period of less than 60 days) in an MPF scheme administered by an MPF approved trustee in Hong Kong and make MPF contributions accordingly. Scheme enrollment can be arranged through MPF registered intermediaries, which include banks and insurance companies. This requirement does not apply for persons exempted from joining a Mandatory Provident Fund ("MPF") scheme.

The newly incorporated company can apply for setting up the Employee's Compensation Insurance and MPF Scheme anytime after incorporation.

The procedure can be done online via various private insurance/MPF providers' web portals. However, most businesses prefer to have advisory meeting with insurance/MPF provider rather than reviewing all information online by themselves.

# Setting up of Business in New York City

**Agency: New York State Department of State, Division of Corporations**

1. **Reserve the company's business name (optional), file the company's articles of organization and adopt the company's operating agreement**

   The company founders may reserve the name of the company with the New York State Department of State Division of Corporations prior to filing the company's articles of organization. To reserve a name, the founders should file an application for Reservation of Name and pay a fee of USD 20.

   The name reservation can be done online at the following: http://www.dos.ny.gov/corps/llccorp.html . The application holds the name for 60 days and may be extended twice for additional periods of 60 days. The fee to extend the reservation of name is also USD 20. The company name must contain the words "Limited Liability Company," "L.L.C.," or "LLC."

   The founders must file the company's articles of organization with the New York Department of State Division of Corporations. Forms can be purchased at a legal supply store or downloaded from the department's website. The application processing time is about 7 business days. However, optional expedited processing is available according to the following fee schedule:

   - 2-hour turnaround: USD 150 (additional fee)
   - Same-day service: USD 75 (additional fee)
   - 24-hour turnaround: USD 25 (additional fee)

   New York State requires an LLC to have a written operating agreement but such agreement does not have to be filed with the state. The business members may enter into an operating agreement before, at the time of, or within 90 days after the filing of the articles of organization. Regardless of when such an agreement was entered into, it may be effective upon the formation of the LLC or at a later date specified in the operating agreement (provided, however, that under no circumstances shall an operating agreement become effective prior to the formation of such company).

2. **Apply for federal Employer identification number (EIN) for tax and employer purposes**

   Agency: US Internal Revenue Service

   The company needs to apply for a federal Employer Identification Number ("EIN"), which is used for tax and employer purposes. Founders must file IRS Form SS-4 (available from the US Internal Revenue Service).

   It is possible to apply online at http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/ Employer-ID-Numbers-EINs (processing time: immediate), by telephone (processing time: immediate), by fax (processing time: 4 business days), or by mail (processing time: 4 weeks). If applicants apply online, they do not need fill out IRS Form SS-4.

3. **Register to collect state sales tax**

   Agency: New York State Department of Taxation and Finance

   Businesses that "sell taxable tangible personal property, perform taxable services, receive amusement charges, or operate a hotel or motel, and restaurants or other establishments that sell food and drink" must register as a sales tax vendor and obtain a Certificate of Authority, as well as those businesses that buy and sell for resale (for example, a wholesale distributor).

   To register, the founders must file Form DTF-17 or register online at the website of the New York State Department of Taxation and Finance (http://www.tax.ny.gov/) After the company has registered, it generally must file quarterly sales and use tax returns regardless of whether it has started or done any business.

   If the company expects to make taxable sales in the State of New York, it must register with the Tax Department at least 20 days before it begins business. New York State will then send to the company a Certificate of Authority which must be displayed at your place of business at all times.

4. **Register as an employer with the Unemployment Insurance Division at the State Labor Department**

   Agency: New York State Department of Labor

   Founders must register as an employer by completing Form NYS-100 to determine whether or not the company is liable under the New York State Unemployment Insurance Law. If the company is determined liable, the Department of Labor will send the company quarterly combined withholding, wage reporting and unemployment insurance returns for reporting wages paid to the company's employees. General business employers may register online at the New York State Department of Labor website (https:// applications.labor.ny.gov/eRegWeb/registerEmployer/uiEPMWelcomeMain.faces) or by completing Form NYS-100 and submitting it by mail or fax.

5. **Arrange for workers' compensation and disability insurance**

   Agency: New York State Workers' Compensation Board

   As New York employers, the LLC founders must obtain and maintain workers' compensation insurance and disability insurance for its employees by purchasing a workers' compensation insurance policy and a disability benefits insurance policy from an authorized private insurance carrier or through the NYS Insurance Fund (or by self-insurance for workers' compensation).

   The company's federal Employer Identification Number ("EIN") is the company's primary identification with respect to communications with the Workers' Compensation Board or by becoming a member of a group self- insurer authorized by the board. The company must give its EIN to its insurance carrier when obtaining or maintaining its workers' compensation or disability coverage. Workers' compensation insurance floor is calculated using each employee's risk classification, salary, and total payoff.

6. **Arrange for publication and submit certificate and affidavits of publication**

   Agency: New York State Department of State, Division of Corporations

Section 206 of the New York State Limited Liability Company Law requires that within 120 days (after the effectiveness of the initial articles of organization), a limited liability company (LLC) must publish in 2 newspapers a copy of the Articles of Organization or a notice related to the formation of the LLC once a week for 6 successive weeks. The newspapers must be designated by the county clerk of the county in which the office of the LLC is located, as stated in the Articles of Organization. One newspaper must be "printed daily" and the other "printed weekly.

The State of New York website has a directory of all New York county websites (http://www.nysegov.com/citguide.cfm?context=citguide&content=munibycounty1), which entrepreneurs can use as a reference to find their relevant county for publishing. The cost of notice of publication varies by county. After publication, the printer or publisher of each newspaper will provide the entrepreneur with a Certificate of Publication, with the affidavits of publication of the newspapers attached. It must be submitted to the New York Department of State, Division of Corporations.

## Setting up of a Business in United Kingdom

**Agency: Companies House**

**Complete application form IN01 and file for registration with Companies House**

Founders of the Company have the option to check for unique company name and file for registration themselves, or to retain incorporation professionals to do so. The option to complete registration is through paper application or electronically.

In case the company chooses to file for incorporation itself online, model articles of incorporation and company memorandum are generated automatically by the registration website www.gov.uk/register-a-company-online. In addition, the above forms, all companies must provide the following information to the relevant Registrar of Companies (i.e., for England and Wales, Scotland, or Northern Ireland):

- Statement of compliance with all requirements of the 2006 Companies Act;
- Application form IN01, which includes:
  - proposed company name;
  - country of registration office (e.g. England and Wales (or Wales), Scotland or Northern Ireland);
  - Whether the liability of the members is to be limited and if so whether by shares or guarantee; and;
  - Whether the company is public or private;
- In the case of a company with a share capital, the application must also include a statement of the capital and initial shareholdings, including the name and address of the subscriber.
- A statement of the proposed officers, being the first director and company secretary (unless in the case of a private company, where the appointment of a company secretary is optional);
- A statement of the intended registered office address.

On completing the online form if the company name provided cannot be used the website will alert you to this and you have the option of selecting another name. Fees for filing incorporation documents are as follows: GBP 12 for a Web filed incorporation and GBP 40 for

paper filers (or GBP 100 for a same day service). The standard digital registration fee through a third-party agent is GBP 10 (or GBP 30 for a same day service). There is no requirement for a company to use a third-party agent. Third party agents may charge additional fees as well as the standard registration fee.

In case the company chooses to retain incorporation agents to file for registration, in addition to the above documents, the application file must include the agents' name and address. Note that in case the company wants to amend model articles of association or company memorandum it cannot file for registration online via www.gov.uk/register-a-company-online . Instead, the company must use professionals to compose incorporation documents and submit them via specialized software to Companies House.

From 30 June 2016, new companies have to provide their People with Significant Control information as part of the incorporation process. The data on beneficial ownership will be accessible and searchable from the database of Companies House.

**Register for PAYE**

Agency: HMRC (His Majesty's Revenue and Customs)

The company must contact the HMRC to set up a contribution scheme for national insurance and pay-as-you-earn (PAYE) tax, which deducts tax from employee wages or salary. The company will be issued with an activation PIN within 5 business days – typically less - and will have to activate this PIN within 28 days (or else request a new PIN). The company will use the PIN to register and enroll online. For security reasons, a check is run on the data provided. A small percentage of registrations who fail the security check can take longer. Otherwise, activation is instant.

Since 6 April 2013, companies have to report their PAYE in real time. This means that companies must either report online or require their accountants to submit reports every time they pay their employees.

**Register for VAT**

Agency: HMRC

A business will need to register for VAT if its taxable goods and services supplied within the UK for the previous 12 months is more than the current registration threshold of GBP 85,000 or the business expects it to go over that figure in the next 30 days alone, it must register for VAT. However, the business may also voluntarily choose to register for VAT if its VAT taxable goods fall under the GBP 85,000 threshold.

Most businesses, including Limited Companies, can register for VAT account online at: https://online.hmrc.gov.uk/ registration or send paper forms through the post. Most applications for VAT registration can be completed online but there are some circumstances where a business has to apply by post. To register online for VAT or use other VAT online services, a business will first need to sign up for HMRC Online Services or the Government Gateway.

**Sign up for employer's liability insurance**

Agency: Insurance company

The Employers' Liability (Compulsory Insurance) Act of 1969 requires all employers in the United Kingdom to maintain employers' liability insurance from an approved insurance company.

The minimum legal requirement for employers' liability insurance is a limit of indemnity of GBP 5,000,000. In addition, a fine of GBP 2,500 per day can be imposed if employer's liability insurance is not taken out.

The Employers' Liability (Compulsory Insurance) Act of 1969 requires that proof of insurance be posted at the workplace. Since October 1, 2008, it is possible to display this information electronically, although a company that wishes to do this will need to ensure that its employees know how and where to find the certificate and have reasonable access to it.

## Setting up of a Business in Canada

Following are the steps involved in setting up of business in Canada:

- **Planning a business**

  Assessing readiness, choosing a business structure, market research and writing a business plan.

- **Choosing a business name**

  Selecting a good name, checking if a name is taken, registering and protecting business name.

- **Registering business with the government**

  Registering or incorporating business, plus how to apply for a business number or tax account.

- **Applying for business permits and licences**

  Permits and licences that may need for business from all three levels of government.

## Setting up of a Business in Australia

To run the business in Australia, one need to register the business. This makes sure that business gets taxed at the right rate, avoids penalties and protects brand and ideas. Following are the steps in brief for setting up of business in Australia:

- **Australian business number (ABN):** An Australian business number (ABN) is unique to business. Customers, suppliers and the Australian Taxation Office (ATO) use this number to help identify business. An ABN is free to register.
- **Business name:** A business name helps customers identify business from others.
- **Tax registrations for business:** Not all taxes will apply to business. It depends on the type of business a person starting.
- **Licences and permits:** From zoning laws to a food licence, the licences and permits will vary. They often depend on the location of the business and the industry.
- **Company:** A company is a legal entity in its own right. If a person has decided a company is the right business structure for the business, this needs to register.
- **Trade mark:** Register the business as a trade mark to protect the business name and brand from being used by others.

# Chapter 11 : Identifying Laws applicable to various Industries and their Initial Compliances

## COMPLIANCE OF INDUSTRY SPECIFIC LAWS APPLICABLE TO AN ENTITY AT THE TIME OF SETTING UP OF THE ENTERPRISE

### Introduction

Under the transforming move of vision New India 2022, India is venerating an emerging market, registering itself as one of the biggest and fastest growing economies in the world. According to various reports, India is cited as having the potential to become the third largest economy in the world in the coming 30 years, behind only China and the USA. Keeping in pace with the contemporary global market and emerging stand of Indian economy, government initiated various flagship programs to boost the entrepreneurship environment in the country. Few of the major flagships including Make in India" coupled with "Ease of Doing Business in India" (EoDB), "Skill India", "Digital India", Atmanirbhar Bharat, etc., were started to build the interest and ease among various domestic and overseas stake holders to set up and advance entrepreneurship in India.

Among the chosen 190 countries, India ranked 63rd in Ease of Doing Business 2020 according to the World Bank Report. In 2014, the Government of India launched an ambitious program of regulatory reforms aimed at making it easier to do business in India. The program represents a great deal of effort to create a more business-friendly environment. India as one of the top 10 improvers, for the 3rd time in a row, with an improvement of 67 ranks in 3 years.

India has emerged as one of the most attractive destinations not only for investments but also for doing business. With the aim to improve the ease of living and the ease of doing business in India, more than 25,000 compliances have been reduced by the Government of India. Positive changes have led to this impressive improvement in India's ranking in the EoDB index.

Indeed, when the entrance and advancement to Indian business market would be of ultimate fortune, there are various laws which need to be abided for successfully setting up and taking forward an enterprise in India.

## SECTION 8 COMPANY

A Section 8 Company, also called as a Non-profit Company, can be incorporated under the provisions of the Companies Act, 2013 having the status of limited company without the addition to its name of the word "Limited" or "Private Limited" for the purpose of promoting commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment or any such other object and the Company shall use its profits or other income in promoting its objects only and prohibit the payment of any dividend to its members as well.

Section 8 company shall enjoy all the privileges and be subject to all the obligations of limited companies. A firm may also be a member of section 8 company.

## Eligibility to apply for Section 8 Company License

An individual or an association of individuals are eligible to be registered as Section 8 Company if it has belowmentioned objectives. The objectives must be confirmed to the satisfaction of the Central Government.

- When the company intends to promote science, commerce, education, art, sports, research, religion, charity, social welfare, protection of the environment or alike other objectives;
- When the company holds an intention to invest all the profits (if any) or any other income generated after incorporation in the promotion of such objects only;
- When the company does not intend to pay any dividend to its members;
- Any failure to meet the prescribed norms formulated by the Central Government may lead to the closure of the Company on the orders of the Central Government.

The Companies registered under the Section 8 of Companies Act, 2013 enjoy the following advantages:

- **Access to Tax benefits:** Since Section 8 companies are charitable institutions, they have access to the various exemptions available under the Income Tax Act. Section 80G of the Income Tax Act renders plenty of tax-related benefits to these companies.
- **Zero Stamp Duty:** The Section 8 Companies are not liable to pay stamp duty on the Memorandum of Association (MOA) and Articles of Association (AOA), unlike other entities incorporated under the Companies Act, 2013.
- **Minimal share capital:** Unlike private limited, public limited, or OPC, a Section 8 company can be set up without the requirement of having minimum paid-up share capital of the Company.
- **Exempted from suffix/prefix of name:** Section 8 companies do not have the compulsion to affix the term like Limited or Private Limited in their name. These entities are registered with limited liability.
- **Separate legal entity:** Section 8 company possesses a distinct legal status which implies that entity's existence is independent of its members. The section 8 entity has perpetual existence.
- **Improved Credibility:** The flexible and transparent constitutional framework of Section 8 companies allows them to garner better credibility than other types of NGOs such as Society and trust.

Reliance Foundation, Infosys Foundation, TATA Foundation, Reliance Research Institute are some commendable examples of successful Section 8 companies registered in India.

## Exemptions Granted to section 8 companies

- **General Meetings:** The Annual General Meetings (AGM) for the Companies can be convened after the short notice period of 14 days under section 108 of Companies Act, 2013.
- **Minutes of the Meeting:** Recording of minutes of General Meetings, Board Meeting and other resolutions is not applicable. However, the minutes of meetings may be recorded within 30 days of conclusion of the meeting in cases where the company's articles provide for confirmation by way of circulation of minutes

- **Audited Financial Statements:** Copies of the audited financial statements and documents can be sent 14 days to the members instead of 21 days.
- **Directorship:** The maximum limit of 15 directors and appointment of more than 15 directors by passing special resolution are not applicable to Section 8 Company.
- **Appointment of Independent Director:** There is no requirement to appoint an independent director for Section 8 Company.
- **Holding of Board Meetings:** The companies are required to hold one Board Meeting within six months. As the companies have to keep four board meetings annually will not apply.
- **Constitution of nomination and remuneration committee and related compliances:** Section 178 of the Act is not applicable to Section 8 Company. Accordingly, Section 8 Companies are not required to have a Nomination and Remuneration Committee and nor a Stakeholders Relationship Committee.
- **No appointment of Company Secretary:** As per the new notification, they do not have to appoint a company secretary. This is the most significant reduction for non-profit companies.

## PARAMETERS FOR DECIDING BUSINESS STRUCTURE

The business structure could be a decisive element in ensuring the success of the organization. Selecting the right structure from various structures can be an intimidating task for anyone but the clarity about the goal and scale of business ease out the process to a considerable extend. The parameters for deciding the business structure are listed below;

- **Control & Management:** Single Business Owners who has the ownership of all the investments should rather go for a One Person Company. However, entrepreneurs with 2 or more proposed owners/directors looking to attract more investments into the firm should rather go for an LLP or a Public / Private Limited Company.
- **Capital Investments:** If you wish to obtain funds from an outside entity, such as an investor, bank, or venture capitalist, you must opt for an authentic business model such as private limited company. Unlike sole proprietorships, Corporations don't necessarily encounter any complication while raising funds from an outside source.

  Also, bigger companies have the liberty to escalate funds by selling shares of stock whereas, sole proprietors can only raise funds via their personal accounts or by taking on partners. An LLP can encounter identical issues, although, as its own entity, it is not always required for the owner to utilize their personal assets or credit.

- **Liability Threshold & Personal Risk:** Owners would want to safeguard their risk under financial pressure. The right business structure could limit exposure to such risks. In the case of partnerships, the partner shares the responsibility to confront risk individually. Certain business structures such as HUF, Sole Proprietors and Partnerships have unlimited liability. Therefore, in case there is any default in the repayment of loans, the money will be recovered from the members or partners in profit sharing ratios. In these cases, the risk to the personal assets of the owners is high. Meanwhile, the business models like LLP & Company provide comprehensive protection to the owner's

liability with a few exceptions. Furthermore, one can also opt for a One Person Company if he/she wishes to mitigate the personal risk to a larger extend.

- **Tax Obligation:** A tax obligation for an LLP owner is more or less equal to the sole proprietor. The income generated from the business is considered personal income and taxed accordingly.

  Small business owners do not wish to confront double taxation in the early stages. The LLP structure prevents that mishap and allows the owner to reap more income. Individuals in a partnership claim their respective profits as a personal income.

  A corporation addresses their tax liability each year, paying taxes on profits after deducting the expenses and payroll. If you pay yourself from the company, you will be liable to pay personal taxes such as for medicare and social security, on your personal return.

- **Licenses, Permits, & Regulations:** Apart from getting legal registration for the business, specific permits and licenses may be required to obtain to operate. Depending on the type of activities and business nature, it may require to be licensed at the local, state, and central levels. States imposed distinctive requirements for different business models. Based on where the business is established, there could be different prerequisites at the municipal level as well. There is no such thing as "generalized structure", so the business must be observant of what applies to them. Liability, tax structure, and industry regulations are the few key parameters that one has to take into account before opting for a business structure.
- **Attracting Investors:** Having an unregistered business structure can be a **hindering** obstacle to attract an investor to raise some capital for the business. Legally established business structures like OPC, Public Company, LLP etc are much more likely to get the vote confidence from investors firm.

**Among others, one important form of business is the Company which is governed under the Companies Act, 2013. The procedure for setting up an enterprise in the form of company could be seen as below:**

## FORMATION OF A COMPANY

Company registration is also referred to as incorporation of company or formation of a business. Registering the company makes it a distinguished entity and gives legal existence. The company registration process in India is done under the Ministry of Corporate Affairs.

It is crucial to be well informed by the registration process and a step-by-step guide to the company registration process in India is given below:

### i. Apply for Director Identification Number (DIN)

The first step towards the company registration process in India begins by obtaining the unique identification number. According to the Companies Amendment Act 2006, all directors in a company need to acquire their Director Identification Number (DIN). DIN is a unique 8-digit number that is issued under section 153 of the Companies Act. The requirements for DIN include full name, father's name, date of birth, identity

proof, address with proof, PAN card copy and two photographs of all the directors proposed.

The application form is available online on the official website of the Ministry of Corporate Affairs (MCA Website) as the DIN-1 Form. The DIN-1 Form must be duly filled and uploaded after paying the applicable fees.

**ii. Apply for Digital Signature Certificate (DSC)**

The authenticity of the documents and information provided in the DIN-1 Form can only be assured by getting a valid digital signature on all the documents submitted in the e-filing process. The company registration process in India requires every business to acquire a Digital Signature Certificate (DSC) to ensure a secure way to get the documents submitted electronically. The requisites for application of digital signature includes proposed directors' full name, father's name, date of birth, address with proof, PAN card copy, identity proof and a photograph

A DSC is distinguished for every business entity and should not be shared by businesses. Normally this digital certification is valid for a period of one or two years, and after expiry, it should be renewed by the Controller of Certification Agencies (CCA) again.

**iii. Filing for New User Registration**

It is important to get registered on the MCA portal. A user account needs to be created for filing an eForm, carrying out different transactions and paying the prescribed fees. The Ministry of Corporate Affairs does not charge any fee for creating an account.

**iv. Application for Company Name**

The proposed company name should be unique and descriptive of the products and services offered by the business. It provides them with a distinguished entity from their competitors in the same field. The Ministry of Corporate Affairs (MCA) has a RUN (Reserve Unique Name) web service for incorporating a company. However, this service can be used only once. Due to a similarity in names or failure to abide by the Companies Incorporation Rules, once rejected, RUN cannot be re-used. Hence, the proposed name must be unique and fulfils all the guidelines prescribed. In case of rejection, the applicant must re-file another RUN form after paying the prescribed fees.

**v. Filing for Charter Documents**

In a company registration process, the applicants are required to create charter documents like Memorandum of Association (MOA) and Articles of Association (AOA).

**Charter Documents of a Company**

Before the registration of the company under the Companies Act 2013, the company should comply with the various charter documents made essential under the concerned law. These are:

**Memorandum of Association**

The MoA sets out the objects for which the company is proposed to be incorporated in the manner provided hereunder:

- The first and foremost clause in MoA shall be the name of the proposed company suffixed with the words limited or private limited, as the case may be;
- The second is the Registered Office Clause, stating the place where the registered office of the company shall be situated;
- The third clause contains the main objects for which the company is going to be formed / incorporated;
- The MoA binds the area of operation of the company in respect to the objects mentioned therein and any decision or actions taken in contravention of the MoA shall be void. A company cannot run any business contrary to the main objects mentioned in their MoA

The MoA and AoA of a company can be modified post incorporation in accordance with the applicable provisions of the Companies Act.

**Articles of Association**

The articles of a company contain regulations for the management of the company. This document is confined to the applicability of the provisions of the companies act on private limited company or public limited company, as the case may be.

**vi. Stamping of Company Documents**

The Memorandum of Association and Articles of Association are the most important documents to be submitted to the ROC for the purpose of incorporation of a company. The Memorandum of Association is a document that states the constitution of the company, objectives, scope of activities of the company and also defines the relationship of the company with the outside world. The Articles of Association contain the rules and regulations of the company for the management of its internal affairs. These documents should be stamped and submitted to the ROC along with relevant forms and registration fee.

**vii. Certificate of Incorporation**

The ROC scrutinizes the documents and, if necessary, instructs the authorised person to make necessary corrections. Thereafter, a Certificate of Incorporation is issued by the ROC, from which date the company comes into existence. It takes one to two weeks from the date of filing of the Memorandum of Association and Articles of Association to receive a Certificate of Incorporation. Although a private company can commence business immediately after receiving the certificate of incorporation, a public company cannot do so until it obtains a Certificate of Commencement of Business from the ROC.

**viii. Register Other Details**

The next step in the company registration process in India includes registering the company name & address and notice for appointment of directors, secretary and

manager. Following this, the company is required to register with the Office of Inspector, Shops and Establishment Act (State/Municipal). The form provides details about the manager's and employer's name, the establishment's name, postal address, the legitimate category. It should be sent to the office of the local shop inspector along with applicable fees. It is obligatory to register the Establishment Act within a month of the opening of your business. Documents required for Company Registration

## Documents required for Company Registration

The general documents that are to be submitted for registration of LLP, One Person Company, Private Limited and Public Limited Company are as follows:

**Documents of the Directors and Shareholders of the company/ Partners of the LLP**

- Proof of identification of all the company's directors and shareholders (partners in case of LLP). Any one of the below documents can be submitted as proof of identification: –
  - Pan card
  - Aadhar card
  - Driving license
  - Passport
- Proof of address of all the directors and shareholders (partners in case of LLP). Any one of the below documents can be submitted as address proof:
  - Latest telephone bill (not older than 2 months)
  - Latest electricity bill (not older than 2 months)
  - Bank account statement having address
- DIN (DPIN in case of LLP) and DSC of all the directors (partners in case of LLP)

**Documents of the Company/LLP**

- Proof of registered office of the company. The below documents must be submitted as address proof of the company:
  - Tenancy/rental agreement between the landlord and company/LLP.
  - Letter or NOC from the landlord of his/her permission to use the office/premises as the LLP's/ company's registered office.
  - Sale deed of the company/LLP office premises in the name of the company/LLP.
- The Memorandum of Association (MoA) which contains the objects of the company for which the company is going to be incorporated and the liability of the members of the company.
- The Articles of the Association (AoA) which lays down the by-laws on which the company will operate.

**Reservation of name or change of name**

An application for reservation of name shall be made through the web service available at www.mca.gov.in by using web service SPICe+ (Simplified Proforma for Incorporating Company Electronically Plus: INC-32), and for change of name by using web service RUN (Reserve Unique Name) along with fee as provided in the Companies (Registration Offices and Fees) Rules, 2014, which may either be approved or rejected, as the case may be, by the Registrar, Central

Registration Centre after allowing re-submission of such web form within fifteen days for rectification of the defects, if any.

The SPICe+ is an integrated Web form offering multiple services viz. name reservation, incorporation, DIN allotment, mandatory issue of PAN, TAN, EPFO, ESIC, Profession Tax (Maharashtra) and Opening of Bank Account. This Form will also facilitate allotment of GSTIN wherever so applied for by the stakeholders. In case the applicant wants to apply for name, incorporation and other integrated services together, he can do so together by filling necessary information in Part A and Part B.

### Features of Spice+ Form

### Part A:

Part A represents the section wherein all details with respect to name reservation for a new company has to be entered.

Part A can either be submitted individually ONLY for name reservation or can be submitted together with SPICe+ Part B for both name reservation as well as incorporation. In case SPICe+ Part A is submitted individually for name reservation, Part B and all other linked forms shall be enabled only after the SRN of SPICE+ Part A is 'Approved' i.e. the name is reserved.

### Part B:

Part B represents the section wherein all remaining details required for incorporation of a company has to be entered. Part B of SPICe+ offers following services viz.

i. Incorporation
ii. DIN allotment
iii. Mandatory issue of PAN
iv. Mandatory issue of TAN
v. Mandatory issue of EPFO registration
vi. Mandatory issue of ESIC registration
vii. Mandatory issue of Profession Tax registration (Maharashtra)
viii. Mandatory Opening of Bank Account for the Company and
ix. Allotment of GSTIN (if so applied for).

An approved name is valid for a period of:

- 20 days from the date of approval (in case name is being reserved for a new company), or
- 60 days from the date of approval (in case of change of name of an existing company).

Users are permitted to apply for two proposed names and one Resubmission (RSUB) is permissible while Reserving Unique Names for companies through the Spice+ Form.

**Guidelines to reserve a company name**

The name of a company should be:

- Unique
- Contain a noun and an activity word that reflects its objectives
- Be in line with Company Name Guidelines issued by Ministry of Corporate Affairs.

The Company Name should not be:

- Be same, similar, identical or resembling to the name of an existing Company or LLP registered. Phonetically similar names are also to be avoided.
- Be similar to a registered trade mark or a trade mark for which an application has already been filed.
- The name chosen should not constitute an offense under any law and should not be undesirable in the opinion of the Central Government.
- The company name should not have any word or expression which is likely to give the impression that the company is in any way connected to the government central or state or any other local authority when it is actually not unless the approval from the respective government authority has been attained.
- If a company's name indicates any activities relating to financing, leasing, chit-fund, investment, securities etc., though the company's business activity is not related to any of such activities than such names shall not be allowed.
- Any descriptive name, wherein the name contains any commonly used words that describe any business activity.

**Simplified Proforma for Incorporating Company [Electronically Plus (SPICe+)]**

(Rule 38 of Companies (Incorporation) Rules, 2014)

(1) The Application for incorporation of a company shall be in [SPICe+ (Simplified Proforma for Incorporating company Electronically Plus: INC-32)] alongwith e-Memorandum of Association (e-MOA) in Form No. INC33 and e-Articles of association (e-AOA) in Form no. INC-34.

Provided that in case of incorporation of a company falling under section 8 of the Act, SPICe+ shall be filed along with Form No. INC- 13 (Memorandum of Association) and Form No. INC-31 (Articles of Association) as attachments.

Provided further that in case of incorporation of a company having more than seven subscribers or where any of the subscriber to the MOA/AOA is signing at a place outside India or in case of Section 8 Company, MOA/AOA shall be filed with SPICe+ in the respective formats as specified in Table A to J in Schedule I without filing form INC-33 and INC-34.

(2) The application for allotment of Director Identification Number upto three Directors, PAN/ TAN, reservation of a name, incorporation of company and appointment of Directors of the proposed for One Person Company, private company, public company and a company falling under section 8 of the Act shall be filed in SPICe+. with the Registrar, within whose jurisdiction the registered office of the company is proposed

to be situated along with the fee of rupees five hundred in addition to the registration fee as specified in the Companies (Registration of Offices and Fees) Rules. 2014:

Provided that where an applicant has applied for reservation of a name and which has been approved therein, he may fill the reserved name as proposed name of the company.

Provided further that in case of companies incorporated, with effect from the 26th day of January, 2018, with a nominal capital of less than or equal to rupees fifteen lakhs or in respect of companies not having a share capital whose number of members as stated in the articles of association does not exceed twenty, fee on INC- 32 (SPICe) shall not be applicable.

(3) For the purposes of filing SPICe Form, the particulars of maximum of three directors shall be allowed to be filled in SPICe+, and allotment of Director Identification Number of maximum of three proposed directors shall be permitted in SPICe+ in case of proposed directors not having approved Director Identification Number.

(4) The promoter or applicant of the proposed company shall propose only one name in SPICe+.

(5) The promoter or applicant of the proposed company shall prepare Memorandum of Association (e-MoA) in Form No. INC-33 and Articles of Association (e-AoA) in Form no. INC-34. Provided that the subscribers and witness or witnesses shall affix their digital signatures to the e-MoA and e-AoA

(6) For incorporation using application as provided in this rule, provisions of the sub-clause (i) of subsection (5) of section 4 of the Act. Rule 9, and clause (a) of sub-rule (1) of rule 16 to the extent of affixing recent photograph shall not apply.

(7) A company using the provisions of this rule may furnish verification of its registered office under subsection (2) of section 12 of the Act by filing SPICe+ in which case the company shall attach along with such Form No.INC-32 (SPICe), any of the documents referred to in sub-rule (2) of rule 25.

(8) Form No.INC-22 shall not be required to be filed in case the proposed company maintains its registered office at the given correspondence address.

(9) Declaration by first subscribers and Directors inform INC-9 shall be generated in PDF and have to be submitted in electronic form except where total number of subscribers and / or directors is greater than 20 or any such subscribers and/ or directors does not have DIN/ PAN.

(10)

a) Where the Registrar on examining SPICe+, finds that it is necessary to call for further information or finds such application or document to be defective or incomplete in any respect, he shall give intimation to the applicant to remove the defects and re-submit the e-form within fifteen days from the date of such intimation given by the Registrar.

b) After the resubmission of the document, if the registrar still finds that the document is defective or incomplete in any respect, he shall give one more opportunity of fifteen days to remove such defects or deficiencies. Provided that the total period for re-submission of documents shall not exceed thirty days.

(11) The Certificate of Incorporation of company shall be issued by the Registrar in Form No. INC-11.

Application for registration of Goods and Service Tax Identification Number (GSTIN). Employee State Insurance Corporation (ESIC) Registration, Employees' Provident Fund organisation (EPFO) Registration and Profession Tax Registration, Opening of Bank Account and Shops and Establishment Registration.

The application for incorporation of a company shall be accompanied by e-form [AGILE-PRO-S] (INC35) containing an application for registration of the following numbers, namely: -

- GSTIN - Optional
- EPFO - Mandatory
- ESIC – Mandatory
- Profession Tax Registration – Mandatory in Maharashtra
- Opening of Bank Account - Mandatory
- Shops and Establishment Registration – Mandatory

## APPLYING FOR BUSINESS LICENSES

Licenses are integral to run any business. Depending on the nature and size of business, several licenses are applicable in India. Knowing the applicable licenses for the enterprises and obtaining them is always the best way to start a business. The lack of relevant licenses can lead to costly lawsuits and unwanted legal battles. Business licenses are the legal documents that allow a business to operate while business registration is the official process of listing a business (along with relevant information) with the official registering authority.

For instance, an e-commerce company may require additional licenses like GST Registration, Professional Tax etc. while a restaurant may require licenses like Food Safety License, Certificate of Environmental Clearance, FSSAI Act, Health Trade License etc. along with the above-mentioned licenses.

There are many factors affect for authorizations of business licenses which may include the type of business ownership, such as partnership, sole proprietor or company, & the number of employees, location of business etc. Business licenses are not only required for new business entity but also required for already established Companies.

The common license that is applicable to all businesses is the Shop and Establishment Act which is applicable to all premises where trade, business or profession is carried out. Other business licenses vary from industry to industry.

To obtain TAN, application must be made for allotment of TAN in Form 49B along with the required supporting documents. Based on the application, the TAN will be allotted to the entity and the entity must quote the TAN in all TDS/TCS returns, TDS/TCS payment challans and all TDS/TCS Certificates. India Filings can help you obtain your TAN registration quickly and hassle-fee. India Filings is an authorized TAN Facilitation Center.

**Employee's State Insurance Registration:** Employee's State Insurance(ESI) is a self-financing social security and health insurance scheme for Indian workers.it offers an economic & medical assurance to workers and its dependents. Besides providing medical benefits to workers and its dependents it also insures worker from temporary or permanent disablement and sickness.

ESI Registration is mandatory for employers having 10 or more employees. For all employees earning Rs.25,000 or less per month as wages. This compulsory insurance also helps employers to cover up their contingent liability of treatment and medical expenses, which may be incurred if any accident is happened at the business premises or factory.

**EPF Registration:** Employees' Provident Fund & Miscellaneous Provisions Act, 1952 is social security legislation for the future benefit of employees & their dependents, in case of unfortunate incidents occurring in the future. Every establishment which is a factory engaged in any industry in which 20 or more person is employed.

EPF Registration has to be done within one month from the date of reaching 20 employees. Any delay in EPF Registration may result in a penalty. Those establishments which do not have the prescribed number of employees but willing to register themselves to provide the benefits of Provident Fund to their employees can register voluntarily with the Regional Provident Fund Office. i.e., covered voluntarily registration.

**GST Registration:** GST Registration is mandatory for every business or corporation involved in buying and selling of goods or services. Those with an annual turnover of more than 20 lakh rupees for supply of services and 40 lakh rupees in case of supply of goods is the threshold limit (exemptions provided to special category states). If a business is carried on without registering under GST, then it will be an offence under GST law. A casual taxable person/ Non-Resident Taxable Person, e-commerce aggregator, agents of supplier and input service distributor etc. are required to register under GST. Moreover, Every GST taxpayer is given a unique identification number called GSTIN during the registration process.

**Udyam Registration:** The Udyam online site handles India's small businesses, there are several advantages to registering, including government credit programmes, subsidies, etc. The requirements for Udyam registration are specified in terms of a composite criteria that takes into account business revenue and investment in machinery and plants.

**FSSAI Registration or License (In case of business of edibles):** This is the national authority for ensuring the safety and standardization of food items in India. FSSAI stands for Food Safety and Standard Authority of India. All retail establishments, trade outlets, kiosks, eateries, caterers, and cloud kitchens must follow to FSSAI regulations, get licenses, and periodically renew their registrations. Under FSSAI, the license or registration is divided into three categories namely:

- FSSAI Central License
- FSSAI State License
- FSSAI State Registration

**Import Export Code:** In India, export and import businesses require a special license known as the Import Export Code, which the Directorate General of Foreign Trade (DGFT) issues under the Ministry of Commerce. The registration can be obtained online at the DGFT website by submitting the mandatorily required documents. The necessary documents are a PAN card, identity card with address proof, business residence proof, current bank account proof, etc.

**Trade License for Indian Online Businesses:** With many easy online business loans available for MSMEs, many small entrepreneurs are looking toward the virtual medium as a preferred business mode. For small businesses, a sole proprietorship is the most convenient way to run a business as fewer compliances are followed. A sole proprietorship can obtain a trading license in the same manner as a traditional shop under the Shop and Establishments Act.

**Licenses needed for an Indian Factory:** Under the Factories Act of 1948, registration is required to operate a factory in India which is granted by the State Government. According to the type of company and state laws governing safety, welfare, and labor standards, there can be extra permission requirements.

**Additional Licensing and Registration:** There are many more company categories that are not included in the list above. Wherever it is judged essential, the government requires licenses and permits to guarantee the welfare of the public and the environment. For example, the Insurance Regulatory and Development Authority supervises insurance firms, while the Reserve Bank of India oversees the banking and microfinance industries.

## Understanding Taxation and Accounting Laws

Taxes are part and parcel of every business. There are a broad variety of taxes, such as, GST state tax and even local taxes that may be applicable for certain businesses. Different business and operating sectors attract different taxes and knowing this beforehand can prove to be useful.

## Adhering to Labour Laws

Labour Laws are needed to ensure that the workers in an organization are not exploited. It acts as a safety net for the weakest segment of society. Hence, the objective of the Labour Laws is to protect the employees and hold the employers accountable for their actions. Thus, these laws are only enforcible in the work environment. The main goal of the said labour law is to create a good atmosphere in the workplace so that people can be productive and can be ensured of their security, both physical and mental. If a company or organisation doesn't comply with the Labour Laws, punitive actions can be taken against them, i.e. they can be punished.

Adhering to labour laws is integral to every organization, small or big. When you are established as a company and have hired people to work for your organization, you are subject to several labour laws regardless of the size of the organization. Laws with regards to minimum wages, gratuity, PF payment, weekly holidays, maternity benefits, Prevention from sexual harassment, payment of bonus among others will need to be complied with.

## Objective of the Labour

Laws Labour Laws aim to correct the power disbalance between the employees and employers. It provides the employees with security so that they can't be unjustly dismissed. Therefore, they give the employees the power to negotiate and ensure a good working conditions. The most important factors that the Labour Laws aim to work on are:

- Productive Work & Adequate Earning
- Proper Working Hours
- Security to the Employees
- Work-Life Balance
- Secure Working Environment
- Sickness and Accident benefits to the employees
- Social Security
- Labour Welfare
- Fair Treatment in the Workplace
- Prevention of Children at Work
- Forced Labour.

Some major labour laws applicable under this scheme are:

- The Industrial Disputes Act, 1947
- The Trade Union Act, 1926
- Building and Other Constructions Workers' (Regulation of Employment and Conditions of Service) Act, 1996
- The Industrial Employment (Standing Orders) Act, 1946
- The Inter-State Migrant Workmen (Regulation of Employment and Conditions of Service) Act, 1979
- The Payment of Gratuity Act, 1972
- The Contract Labour (Regulation and Abolition) Act, 1970
- The Employees' Provident Funds and Miscellaneous Provisions Act, 1952
- The Employees' State Insurance Act, 1948
- The Factories Act, 1948.

Having a well-designed employee policy can be a major differentiator for new companies to set up and advance well. An attractive employee policy can be the key to attract and retain good talent. Employee policies can also prove to be the starting point for boosting employee morale and increasing productivity.

## Adherence to Laws relating to Intellectual Property

The twenty-first century witnessed the emergence of "Intellectual Capital" as a key wealth driver of international trade between countries, thanks to rapid globalization and liberalization of economies the world over. Intellectual property rights have become an irreplaceable element of India's business fraternity, whether in terms of new statues or judicial pronouncements. India's consent of the WTO (World Trade Organization) agreement has paved the way for its compliance with TRIPS (Trade Related Aspects of Intellectual Property Rights).

Further, Intellectual property is vital for most businesses in the contemporary regime of knowledge and innovation, especially for tech centric businesses. Codes, algorithms and research findings among others are some of the most common intellectual property owned by organizations. Therefore, one has to ensure strict adherence to the Laws relating to Intellectual Property in India as well as of International Application to which India is a signatory. For the effective implementation of the IP Laws, facilitators have been empanelled by the Controller General of Patents, Trademarks and Design. Such facilitators help the new enterprises in setting up their business under the vigil of IPRs by providing advisory services, assisting in patent filing and disposal of patent application among other services at a minimum charge.

The well-timed and careful examination of IP rights of third parties can prevent, or at least shorten, the infringement of rights and the associated long legal processes. For this reason, these processes are now considered as compliance for many companies. Patent attorneys can assist companies in developing tailored solution for its industry requirements and setting up corresponding IP guidelines.

The TRIPS agreement has made way for the harmonization of Indian laws connected with Intellectual Property Rights. The agreement was implemented with the minimum standards for the protection of IPR.

A time-frame has been specified within which the participating countries are required to effect changes in their respective laws to meet the requisite compliance standards. The rest of the article seeks to highlight the amendments brought forth by the agreement in intellectual property laws.

The Office of the Controller General of Patents, Designs and Trademarks controls all patents in India.

World Intellectual Property Organization (WIPO), international organization designed to promote the worldwide protection of both industrial property (inventions, trademarks, and designs) and copyrighted materials (literary, musical, photographic, and other artistic works). The organization, established by a convention signed in Stockholm in 1967, began operations in 1970 and became a specialized agency of the United Nations in December 1974. It is headquartered in Geneva.

WIPO cooperates with intellectual property (IP) offices, users and other stakeholders to develop shared IP tools, services, standards, databases and platforms. This technical infrastructure is designed to help IP institutions collaborate more effectively and deliver more efficient services to their users; as well as enabling innovators and information-seekers worldwide to freely access the knowledge contained in the IP system. WIPO provide human capacity building across the full spectrum of intellectual property (IP) rights: patents, trademarks, industrial designs, geographical indications and copyright. Training takes place through in-depth programs offered by the WIPO Academy or tailor-made technical workshops.

## Ensuring Effective Contract Management

Contracts lie at the crux of running any business. A contract is required to ensure the smooth functioning of work and is a great mechanism to ensure recourse in case of non-fulfilment of work. Having basic knowledge about various aspects of contract management can prove to be useful for entrepreneurs. As per the Indian Contract Act, 1872, all agreements are contracts if they are made by the free consent of parties competent to contract, for a lawful consideration with a lawful object, and are not expressly declared to be void.

Employee contracts are one of the most crucial aspects to be looked into while starting a venture. Founders many a time collaborate with their own trusted circle of friends in the beginning and while this ensures a certain ease and efficiency to business operations, outlining and formalizing employee contracts with details about salary, scope of work and stock options (if any) with even your first few employees is always recommended. Having this clarity from the very beginning helps the new businesses to reduce risks at a later point in time.

Contract management involves overseeing agreements made with suppliers, customers, partners and employees. Effective oversight is critically important because sales can be lost and regulatory penalties can ensue from poor contract management. In the early stage of operations and post operation too, there are various contracts that a company has to abide by, therefore, the adherence to contract law is one of the most important requirement for the company.

**Details about winding down the business:**

Closing a company is a difficult call to make for any entrepreneur. When a company decides to shut down, all the stakeholders from vendors to employees to customers and investors need to be informed in advance and the whole process must be properly planned and executed in order to make the exit easy on everyone.

It is the last stage of existence of a company and all its assets are used to pay off the creditors, shareholders and other liabilities.

## Specific Laws and General Laws

Segregation of laws applicable on the Company into the Industry specific and general is essential for Secretarial Audit. After considering the following factors the auditor should make the segregation of the same based on the laws being applicable on the Company:

- Key financial parameters such as turnover, paid-up share capital, net worth, borrowings, etc.
- Geographic location of registered office, units / divisions / plants / branches, etc.
- Status of company such as listed / unlisted.
- Type / class of company such as Private, Public, Holding, Subsidiary, Foreign, Nidhi, Producer, Section 8, etc.
- Registration with various authorities such as SEZ, Sectoral Regulators, etc.
- Segment such as manufacturing / trading / service / e-commerce and industry classification thereof.
- Agreements governing rights, obligations of shareholders such as Joint venture, shareholders' agreements.

- Number, class and category of employees / workers such as women, contractual employees, etc.

# Chapter 12 : Various Initial Registrations and Licenses

## INTRODUCTION

A business entity is required to secure various registration and licenses in order to set up its businesses in India. This chapter deals with the list of mandatory as well as additional initial registration requirements and the licenses along with their detailed procedures.

'Ease of doing business' refers to the regulatory environment in a country to set up and operate a business. Every year, the World Bank compares the business environment in 190 countries in its Ease of Doing Business Report. Among the chosen 190 countries, India ranked 63rd in Doing Business 2020: World Bank Report. In 2014, the Government of India launched an ambitious program of regulatory reforms aimed at making it easier to do business in India. The program represents a great deal of effort to create a more business-friendly environment.

India has emerged as one of the most attractive destinations not only for investments but also for doing business. India jumps 79 positions from 142nd (2014) to 63rd (2019) in 'World Bank's Ease of Doing Business Ranking 2020.

### Business Entity Registration

To start a business, it is necessary for an entrepreneur to decide the form of business entity through which he wish to carry out his business. The business entity that he could seek for are following:

| *S.No.* | *Form of Business Entity* | *Law under which Registration is required* |
|---|---|---|
| 1. | Proprietorship | Not required |
| 2. | Partnership | Not compulsory but can be registered under the Partnership Act, 1932 |
| 3. | Private Company | The Companies Act, 2013 |
| 4. | Public Company | The Companies Act, 2013 |
| 5. | Limited Liability Partnership | The Limited Liability Partnership Act, 2008 |
| 6. | One person company | The Companies Act, 2013 |

The entity after registration needs to open Current Account in Bank before starting business transactions. However, proprietor and partnership firm can open Current Account in Bank and need not wait for registration certificate.

### Mandatory Registration

- PAN & TAN
- GST
- MSME
- ESI
- EPF
- Shops & Establishment

# PAN

**What is PAN?**

PAN is a Permanent Account Number (in short called as PAN) and is a vital document for any taxpayer. It is a 10-character alphanumeric number consisting of letter and digits e.g. (AAAAA1234A). PAN is issued in the form of a laminated plastic card. PAN card requirements are detailed in the Income Tax Act of 1961.

**Utility of PAN:**

- This number is unique to each cardholder and helps identify the income tax payer.
- PAN enables the department to identify/ link all transactions of the PAN holder with the department. These transactions include tax payments, TDS/TCS credits, returns of income, specified transactions, correspondence etc, and so on.
- It facilitates easy retrieval of information of PAN holder and matching of various investments, borrowings and other business activities of PAN holder.
- It also serves as an identity proof for a large number of purposes e.g. Sale or purchase, by any person, of shares of a company not listed in a recognised stock exchange for amount exceeding Rs. 1 lakh per transaction, Sale or purchase of any immovable property for an amount exceeding Rs. 10 lakh or valued by stamp valuation authority referred to in section 50C of the Act at an amount exceeding ten lakh rupees etc.

**For whom it is mandatory to obtain PAN:**

- Every person if his total income or the total income of any other person in respect of which he is assessable during the year exceeds the maximum amount which is not chargeable to tax
- A charitable trust who is required to furnish return under Section 139(4A)
- Every person who is carrying on any business or profession whose total sale, turnover, or gross receipts are or is likely to exceed five lakh rupees in any year
- Every person who intends to enter into specified financial transactions in which quoting of PAN is mandatory
- All non-individual resident persons and persons associated with them shall apply for PAN if the financial transaction entered into by them during the financial year exceeds Rs. 2,50,000.

## Significance of PAN for Setting up of Business

Some of the reasons why holding a PAN is important for every business entity are listed below:

It was made mandatory by the Government of India under the Income Tax Act, 1961. The Act was subsequently amended and Section 206AA, as inserted in 2009 by the Finance Act, now mandates all foreign parties that provide or generate payment to a counterpart in India to provide their PAN. This includes not only individuals but also incorporations, companies, limited companies and any other form of entity.

- In the absence of the PAN, the Government will charge withholding tax which can be at the rate of more than 30% of the total invoiced payment.
- It serves as a reference number of its holder for the Income Tax Department to track the financial transactions carried out by it. In respect of certain transactions,

the person is now required to quote his PAN as also deposit certain income tax documents.

- Even if one is not required to pay income tax, it is mandatory for him to hold a PAN if he is earning money.
- Companies, regardless of whether they are registered abroad or in India, are required to pay tax for businesses carried out in India. Without the PAN, the government has the mandate to deduct tax at the highest possible rate.
- PAN helps an individual to pay for his invoices, remittances, and is also required to be mentioned in the income tax return.
- Just like individuals, companies are required to provide their Tax Registration Number (TRN) to whomever is paying them. A TRN can be obtained only when the company holds a PAN.

## Application and Registration of PAN

The PAN (Permanent Account Number) card is an important document for conducting even the simplest of financial transactions like opening a savings bank account or applying for a debit/credit card.

Application for PAN can be made both online and offline as per the forms specified by the income tax department (i.e., form 49A for resident individual) together with the supporting documents as proof of identity, address and date of birth. Indian citizens will have to submit their 'Application for allotment of new PAN' in revised Form 49A only. Foreign citizens will have to submit their 'Application for allotment of new PAN' in newly notified Form 49AA only.

For New PAN applications, in case of Individual and HUF applicants, if address for Communication is selected as Office, then Proof of Office Address along with Proof of residential address is to be submitted with NSDL in respect of applications made on and after 1st November 2009.

Individual applicants will have to affix two recent, coloured photograph (Stamp size 3.5 cms x 2.5. cms) on PAN application form in case application are made physically.

### Linking of PAN with Aadhar

As per Section 139AA, every person who is eligible to obtain Aadhar is required to quote his Aadhar number in the PAN application form with effect from 1st day of July, 2017. If any person does not possess the Aadhar Number but he had applied for the Aadhar card then he can quote Enrolment ID of Aadhar application Form.

In case of an applicant, being a company, which has not been registered under the Companies Act, 2013, the application for allotment of a Permanent Account Number may be made in Spice +specified under sub-section (1) of section 7 of the said Act for incorporation of the company.

## TAN

Tax Deduction Account Number or Tax Collection Account Number is a 10 -digit alpha-numeric number issued by the Income-tax Department. TAN is to be obtained by all persons who are responsible for deducting tax at source (TDS) or who are required to collect tax at source (TCS).

## Persons liable to apply for TAN

1. Every person liable to deduct tax at source or collect tax at source is required to obtain TAN. However, a person who is required to deduct tax under section 194-can use PAN in the place of TAN as such person is not required to obtain TAN.
2. As per section 194-IB any individual or HUF [whose books of account are not required to be audited under section 44AB] is liable to deduct tax at the rate of 5% while making payment of rent of any land or building or both to a resident person if amount of rent exceeds Rs. 50,000 for a month or part of a month.
3. Section 194M provides for deduction of tax, at the rate of 5%, from the sum paid or credited to a resident, in a year on account of contractual work, commission (not being insurance commission as referred to in Section 194D), brokerage or professional fees, by an individual or a HUF [whose books of account are not required to be audited under Section 44AB], if aggregate of such sum exceeds Rs. 50 lakhs in a year.

## Relevance of TAN

As per section 203A of the Income-tax Act, 1961, every person who deducts or collects tax at source has to apply for the allotment of TAN. Section 203A also makes it mandatory to quote TAN in following documents:

- TDS/ TCS statements i.e., return;
- Statement of financial transactions or reportable accounts;
- Challans for payment of TDS/TCS;
- TDS/TCS certificates;
- Other documents as may be prescribed.

The provisions relating to obtaining of TAN will not apply to a person deducting tax under section 194-IA (i.e., from sale consideration of land/building) and to such person, as may be notified by the Central Government in this behalf.

## Procedure to Apply for TAN

There are two modes for applying for TAN:

- OFFLINE - An application for allotment of TAN is to be filed in Form 49B in duplicate and submitted to any TIN-Facilitation Centre (TIN-FC) of NSDL. Addresses of TIN FCs are available at NSDL TIN website (https:// www.tin-nsdl.com).
- ONLINE — Online application for TAN can be made from the website of NSDL TIN website.

Applicants should go through the instructions and guidelines provided in the application form before filling the Form. In case of an applicant being a company, which has not been registered under the Companies Act, 2013, the application for allotment of Tax Deduction Account Number may be made in Form SPICe+ specified under the Companies Act, 2013.

## Where to get the Physical Application Forms

Places from where to obtain Form 49B are:

1. Form 49B is freely downloadable from the website of Income-tax Department (http://www.incometaxindia.gov.in)
2. It is also available at TIN-FCs.
3. Legible photocopies of Form 49B or forms legibly printed exactly as per the format prescribed by Income-tax Department are also allowed to be used.

No separate TAN is required to be obtained for the purpose of TCS, if the person already holds TAN for the purpose of TDS.

### Documents to be submitted along with TAN application

No documents are required to be submitted along with application for allotment of TAN. However, for online application, the signed acknowledgment which is generated after filling up the form is to be forwarded to NSDL.

### Communication

These applications are digitized by NSDL and forwarded to ITD. ITD will issue the TAN which will be intimated to NSDL online. On the basis of this, NSDL will issue the TAN letter to the applicant.

### Status track

The applicants may track the status of their TAN application using 14-digit unique Acknowledgment Number after three days of application using the status track facility. This facility can be accessed from the website of Income-tax Department too (www.incometaxindia.gov.in).

### Fee

Fee for filing the TAN application + GST as applicable (the application fees may change from time to time).

## GST REGISTRATION

**What are Goods and Services Tax (GST)?**

Goods and Services Tax is an Indirect Tax levied on goods and services. It's a revolutionary change under the tax regime to create a One Nation, One Tax and One Market i.e. "One Nation One Tax". GST was rolled out on July 1st, 2017 replacing the Indirect taxes like excise duty, service tax, value added tax, central sales tax, purchase tax, entertainment tax, luxury tax and octroi that was levied by the central and states separately at different tax rates.

After the GST came into effect, only value addition is taxed eliminating the cascading effect or "TAX on TAX "and levied at similar rates on same products across the country that has been simplified in terms of single registration and completely digitalized.

**GST in India is classified into four types:**

| *Type of GST* | *Who levies it?* | *Transactions on which SGST is levied* |
|---|---|---|
| SGST (State Goods and Service Tax) | State Government | Intra-State goods and service transactions |
| UGST (Union Territory Goods and Service Tax) | Union Government | Intra-union territory goods and service transactions |
| CGST (Central Goods and Service Tax) | Central Government | Intra-State goods and service transactions |
| IGST (Integrated Goods and Service Tax) | Levied by Central Government and revenue is shared both between Central Government and State Government | Inter-State goods and service transaction Import and Export |

## GST Registration

Registration of any business entity under the GST Law implies obtaining a unique number from the tax authorities for the purpose of collecting tax on behalf of the government and to avail Input tax credit for the taxes on his inward supplies. GST being tax on the event of 'Supply' every supplier needs to get registered. Section 22 of Central Goods and Services Tax Act, 2017 mandates the Registration of every supplier of goods whose turnover exceeds INR 40 Lakhs in a financial year.

For special category states such as north eastern states, Jammu and Kashmir, Himachal Pradesh and Uttarakhand, the threshold limit is INR 10 lakhs. The threshold limit for service providers is INR 20 Lakhs across India and in case of special category states, the limit is INR 10 lakhs.

## Persons not liable to register

The following persons are not liable to registration as per section 23 of Central Goods and Services Tax Act,2017.

- Persons engaged exclusively in the business of supplying goods or services or both that are not liable to tax;
- Persons engaged exclusively in the business of supplying goods or services or both wholly exempt from tax;
- Agriculturist, to the extent of supply of produce from land cultivation;
- Specified categories as may be notified by the Government.

## Compulsory registration

Section 24 of Central Goods and Services Tax Act,2017provides for compulsory registration for certain category of persons irrespective of their turnover that is to say, the threshold exemption of 40 lakh rupees or 20 lakh rupees as the case may be is not available to them.

- Inter State Suppliers persons making any inter-State taxable supply;
- casual taxable persons;
- persons taxable under reverse charge;
- person who are required to pay tax under sub-section (5) of section 9;
- non-resident taxable persons;
- persons who are required to deduct tax under section 51, whether or not separately registered under this Act;
- persons who make taxable supply of goods or services or both on behalf of other taxable persons whether as an agent or otherwise;
- Input Service Distributors;
- Suppliers who supply goods through electronic commerce operators;
- every electronic commerce operator who is required to collect tax;
- every person supplying online information and database access or retrieval services from a place outside India to a person in India, other than a registered person.

**Aggregate Turnover** under the Act includes the aggregate value of all of the following supplies of a person having the same PAN.

- taxable supplies,
- exempt supplies,

- zero-rated supplies,
- interstate supplies,
- but doesn't include the inward taxable supplies under the Reverse Charge Mechanism.

If the person has taxable and exempt supplies as a part of the turnover, example, machine oil and petrol, the turnover from both would be added to determine whether the aggregate exceeds the threshold, and if it does, then registration becomes mandatory for such supplier.

The supplies by the agents on behalf of the principal would be included in the aggregate turnover of both, the principal and the agent. Registration is mandatory at every place of business from wherein a taxable supply has been made

## GSTIN

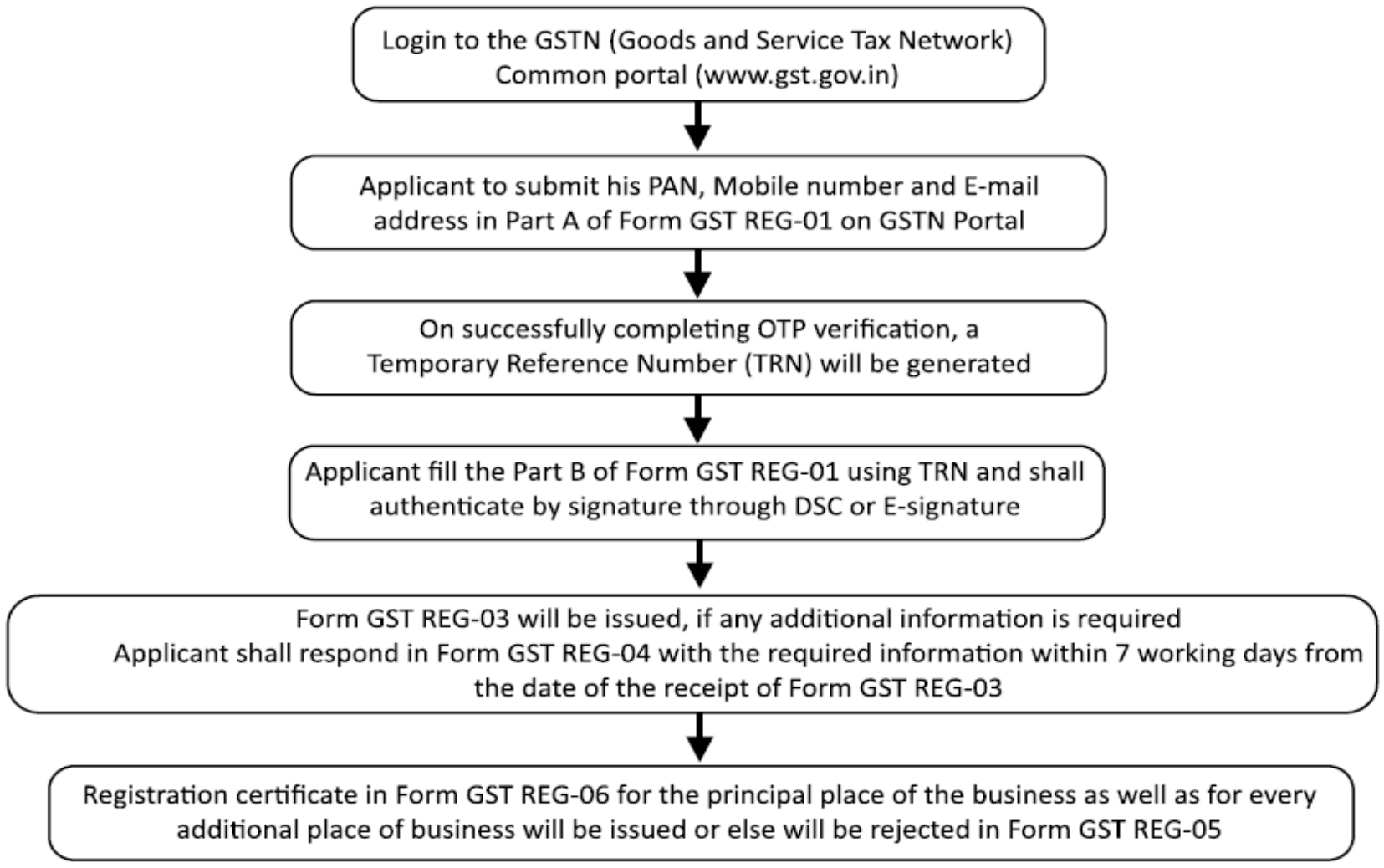
The registration in GST is based on Permanent Account Number and State specific. Supplier has to register in each of such State or Union territory from where he effects supply. In GST registration, the supplier is allotted a 15-digit GST identification number called "GSTIN" and a certificate of registration incorporating therein this GSTIN is made available to the applicant on the GSTN common portal.

- The first two digits of this number will represent the State code;
- The next ten digits will be the PAN number of the taxpayer;
- The thirteenth digit will be assigned based on the number of registrations within a State;
- The fourteenth digit will be Z by default;
- The last digit will be for check code.

A given PAN based legal entity would have one GSTIN per State, that means a business entity having its branches in multiple States will have to take separate State wise registration for the branches in different States. But within a State, an entity with different branches would have single registration wherein it can declare one place as principal place of business and other branches as additional place of business. However, a business entity having separate business verticals (as defined in section 2 (18) of the CGST Act, 2017) in a state may obtain separate registration for each of its business verticals.

## Procedure for Registration

GST registration process will be online through a portal maintained by GSTN (Goods and Services Tax Network). Steps for GST registration are:




## Composition Scheme under GST

The composition levy is an alternative method of levy of tax designed for small taxpayers whose turnover is up to Rs. 1.5 Crores (Rs. 75 lakhs in case of few States). The objective of composition scheme is to bring simplicity and to reduce the compliance cost for the small taxpayers. Moreover, it is optional and the eligible person opting to pay tax under this scheme can pay tax at a prescribed percentage of his turnover every quarter, instead of paying tax at normal rate.

Composition Scheme is now made available to service providers (32nd GST Council meeting ) whose aggregate annual turnover does not exceed Rs. 50 lakhs. Both exclusive service providers and mixed service providers of goods and services can opt for this scheme.

## Persons not eligible for Composition Scheme

- any supply of goods which are not liable to be taxed under this Act;
- inter-State outward supplies of goods;
- supplies through electronic commerce operators who are required to collect tax under section 52;
- a manufacturer of notified goods;
- a casual dealer;
- a Non-Resident Foreign Taxpayer;
- a person registered as Input Service Distributor (ISD);
- a person registered as TDS Deductor/Tax Collector.

Under this scheme, a taxpayer will pay tax as a percentage of his/her turnover during the financial year without the benefit of Input Tax Credit. A taxpayer opting for composition scheme will not collect any tax from his/her customers and show only Bill of supply instead of invoice. The floor rate of tax for CGST and SGST are as follows:

| | |
|---|---|
| Manufactures and Traders | 1% |
| Restaurants not serving alcohol | 5% |
| Other Service Providers | 6% |

When the eligible taxpayer is opting for the Composition Scheme under GST, a taxpayer has to file a quarterly statement in Form CMP-08 and a return in Form GSTR -4 annually.

## Persons not eligible for Composition Scheme

**Process for registration as Composite taxpayer:**

A person who is applying for the fresh Registration under GST has to file FORM REG-01 and under Part B of the form, he has to select the option of Section 10 (Registration as composite taxpayer).

**Registration under the Act in special cases:**

**1) Person required to deduct tax at source or collect tax at source**

- **Electronic filing of application:** Any person required to deduct tax in accordance with the provisions of section 51 or a person required to collect tax at source in accordance with the provisions of section 52 shall electronically submit an application, duly signed or verified through electronic verification code, in FORM GST REG-07 for the grant of registration through the common portal.
- If the applicant is applying in a State or Union territory where he does not have a physical presence, he shall mention the name of the State or Union territory in PART A of the application in FORM GST REG-07 and mention the name of the State or Union territory in PART B thereof in which the principal place of business is located which may be different from the State or Union territory mentioned in PART A.
- **Certificate of registration:** After due verification, the proper officer may grant certificate of registration in FORM GST REG-06 within a period of three working days from the date of submission of the application.

**2) Non-resident taxable persons:**

- Section 2(77) of Central Goods & Services Tax Act, 2017 defines "non-resident taxable person" as any person who occasionally undertakes transactions involving supply of goods or services or both, whether as principal or agent or in any other capacity, but who has no fixed place of business or residence in India. Hence, a non-resident taxable person is someone who has a business outside India, but comes to a different state for a business purpose temporarily. For example, a person from Paris, comes to participate in an exhibition at Azad Maidan, Mumbai for participating in the exhibition, then such person would need to register as a non-resident taxable person at Mumbai and he will be granted registration for a maximum period of 90 days.
- A non-resident taxable person shall electronically submit an application, along with a self-attested copy of his valid passport, for registration, duly signed or verified through electronic verification code, in FORM GST REG-09, at least five days prior to the commencement of business at the common portal.

- In the case of a business entity incorporated or established outside India, the application for registration shall be submitted along with its tax identification number or unique number on the basis of which the entity is identified by the Government of that country or it's Permanent Account Number, if available.
- A person applying for registration as a non-resident taxable person shall be given a temporary reference number by the common portal for making an advance deposit of tax and the acknowledgement under shall be issued electronically only after the said deposit in his electronic cash ledger.
- The application for registration made by a non-resident taxable person shall be duly signed or verified through electronic verification code by his authorised signatory who shall be a person resident in India having a valid Permanent Account Number.

**3) Person supplying online information and database access or retrieval services from a place outside India to a non-taxable online recipient:**

- electronically submit an application for registration, duly signed or verified through electronic verification code, in FORM GST REG-10, at the common portal.
- Registration is granted in FORM GST REG-06, subject to requisite conditions and restrictions.

**4) Suo moto registration:**

- Where, pursuant to any survey, enquiry, inspection, search or any other proceedings under the Act, the proper officer finds that a person liable to registration under the Act has failed to apply for such registration, such officer may register the said person on a temporary basis and issue an order in FORM GST REG-12.
- The registration so granted shall be effective from the date of such order granting registration.
- Every person to whom a temporary registration has been so granted shall, within a period of ninety days from the date of the grant of such registration, submit an application for registration as required in the case of mandatory registration.
- Provided that where the said person has filed an appeal against the grant of temporary registration, in such case, the application for registration shall be submitted within a period of thirty days from the date of the issuance of the order upholding the liability to registration by the Appellate Authority.
- The Goods and Services Tax Identification Number assigned, pursuant to the verification, shall be effective from the date of the order granting such registration.

**5) Casual Taxable Person:**

- Section 2(20) of Central Goods & Services Tax Act, 2017 defines "casual taxable person" as a person who occasionally undertakes transactions involving supply of goods or services or both in the course or furtherance of business, whether as principal, agent or in any other capacity, in aState or a Union territory where he has no fixed place of business. Thus, a casual taxable person is someone who has a business in a different state, but comes to a different state for a business purpose temporarily.
- For example, a footwear dealer registered in Agra comes for an exhibition at Azad Maidan, Mumbai for participating in the exhibition, then such person would need to register as a casual taxable person at Mumbai and he will be granted registration for a maximum period of 90 days.

**Important points:**

Registration must be taken state-wise. In case there are several branches within a single state, they can all operate under a single registration so long as one of the places are declared as Principle Place of Business (PPOB) and the remaining are Additional Places of Business (APOB).

- Any person having multiple places of business within a State or a Union territory, requiring a separate registration for any such place of business under sub-section (2) of section 25 shall be granted separate registration in respect of each such place of business provided such person has more than one place of business as defined in clause (85) of section 2. A registered person opting to obtain separate registration for a place of business shall submit a separate application in FORM GST REG-01 in respect of such place of business. Rest of the procedure is same as in case of mandatory registration.
- For composition levy, all businesses under a single PAN mandatorily either can be registered under composition levy or all of them under normal levy and there is no facility of choosing the Composition Scheme for only a few businesses under the Goods & Services Tax Act, 2017.
- **Furnishing of Bank Account Details -** After a certificate of registration in FORMGST REG-06 has been made available on the common portal and a Goods and Services Tax Identification Number has been assigned, the registered person, except those who have been granted registration under rule 12 or, as the case may be rule 16, shall as soon as may be, but not later than forty five days from the date of grant of registration or the date on which the return required under section 39 is due to be furnished, whichever is earlier, furnish information with respect to details of bank account, or any other information, as may be required on the common portal in order to comply with any other provision.
- Display of registration certificate and GSTIN on the name board:
  1) Every registered person shall display his certificate of registration in a prominent location at his principal place of business and at every additional place or places of business.
  2) Every registered person shall display his Goods and Services Tax Identification Number on the name board exhibited at the entry of his principal place of business and at every additional place or places of business.

## REGISTRATION UNDER SHOPS & ESTABLISHMENTS ACT

One of the important regulations to which most businesses in India are subject to is the Shop and Establishment Act, enacted by every state in India. The Shop and Establishment (S&E) Act is applicable on all the commercial establishments; viz, business centres, offices, warehouses, stores, hotels, eateries, amusement parks, theatres, etc., nationwide. It is one of the most important regulations required to be complied with for any business. The Act is designed to regulate payment of wages, hours of work, leave, holidays, terms of service and other work conditions of people employed in shop and commercial establishments.

## Purpose of Shop and Establishment Act

The Shop and Establishment Act in India is promulgated by the State and may slightly differ from state to state. However, as per the Act, all shops and commercial establishments operating within each state are covered by the respective Shop & Establishments Act.

**Key Definitions:**

- "Shop": Shop means any premises where:
  (i) goods are sold, either by retail, wholesale, or
  (ii) services are rendered to customers.

  It includes an office, a store-room, god own, warehouse, or workplace, whether on the same premises or otherwise, used in connection with such trade/ business. A shop however does not include a factory or a commercial establishment.

- "Commercial Establishment": Commercial establishment means
  (i) a premise where any trade, business, profession or any work is undertaken,
  (ii) which may include society, charitable or another trust, journalistic and printing establishments, contractors and auditors establishments, educational institutes, premises where the business of banking, insurance stocks, and shares, the brokerage is undertaken, restaurants and eating houses, residential hotels, clubs, theatres and other places of public amusement or entertainment.

  Establishments are defined as shop, a commercial establishment, residential hotel, restaurant, eating-house, theatre or other places of public amusement or entertainment. Further, establishments as defined by the Act may also include such other establishments as defined by the Government by notification in the Official Gazette. However, factories are not covered by the shops & establishments Act and are regulated by the Factories Act, 1948.

## License under Shop and Establishment Act

Any shop or commercial establishment that commences operation must apply to the Chief Inspector for a Shop and Establishment Act License within the prescribed time.

The application for license in the prescribed form must contain:

- the name of the employer,
- address of the establishment,
- name of the establishment,
- category of the establishment,
- number of employees, and
- other relevant details as requested.

On submission of the application and review by the Chief Inspector, the shop or commercial establishment will be registered and a registration certificate will be issued to the occupier. The registration certificate must be prominently displayed at the shop or commercial establishment and renewed periodically, as per the Act.

## Registration of Shops & Establishments

As a business owner of a shop or establishment, you are compulsorily required to get the same registered under the Shops and Establishment Act. Here are the specific rules:

1. Submit an application in the prescribed form to the Inspector of the area within 30 days of starting any work in the shop/establishment. The application is to be submitted along with the prescribed fees and should contain the following information:
    a. Name of the employer and the name of a manager, if any;
    b. The postal address of your establishment;
    c. The name of establishment;
    d. Such other particulars as may be prescribed.
2. Upon receiving the application for registration and the fees, the Inspector shall verify the accuracy and correctness of the application. Once suitably satisfied, he shall enter the details in the Register of Establishments and issue a registration certificate for the establishment. This certificate will be valid for 5 years and has to be renewed thereafter.

It is important that the registration certificate has to be prominently displayed at the establishment.

The Labour Department of each state has the authority for the registration process. Many States have a 100% online process, while some states are still following the manual procedure for filing.

The Registration certificate is required to be renewed periodically as mentioned in the state regulations.

## ESI REGISTRATION

Employee State Insurance (ESI) is a social security scheme offered by the Government of India as per the Employees' State Insurance Act, 1948. It is a self-financing scheme i.e. in the form of contribution from both Employees and Employers for the protection of Employees against the impact of incidences of sickness, maternity, disablement and death due to employment injury and to provide medical care to insured persons and their families. The ESI Scheme applies to factories and other establishment's viz. Road Transport, Hotels, Restaurants, Cinemas, Newspaper, Shops, and Educational/Medical Institutions wherein 10 or more persons are employed.

Employees' State Insurance Corporation (ESIC) is a social government organization established under Employees' State Insurance Act, 1948 to manage the funds according to the rules and regulations of ESI Act.

## Applicability

The ESI Act is applicable to all non-seasonal factories and has been extended to the factories and other establishments here as under:

| *Section* | *Coverage* |
|---|---|
| **Section 2(12)** | all non-seasonal factories employing 10 or more persons. |
| **Section 1(5)** | The State Governments have extended the coverage under Section 1(5) of the Act to Shops, Hotel, Restaurants, Cinema including preview theatres, Road-motor transport undertakings, Newspaper establishments, Private Medical Institutions, Educational Institutions and to contract and casual employees of Municipal Corporation/Municipal Bodies employing 10 or more persons in the certain States/UTs where the State Government is appropriate government. |
| **Section 1(5)** | The Central Government. has extended the coverage under Section 1(5) to Shops, Hotels, Restaurants, Road Motor Transport establishments, Cinema including preview theatres, Newspaper establishments, establishment engaged in Insurance Business, Non-Banking Financial Companies, Port Trust, Airport Authorities, Warehousing establishments employing 20 or more Persons where the Central Government is appropriate government. |

### Wage Limit for Registration

- Employees of the aforesaid categories of factories and establishments, drawing wages upto Rs.21,000/- per month, are entitled to social security cover under the ESI Act.
- For Disabled persons, the wage Limit is Rs.25,000/- per month.
- Employee contribution: 0.75% of total salaries. Employer Contribution: 3.25% of total wages. (with effect from 01st July 2019)

## ESI Registration Procedure for both Employer & Employee

### Online Registration of Employers

The Ministry of Labour and employment, Central Government has launched Unified Shram Suvidha Portal to facilitate reporting of Inspections, and submission of Returns. The Unified Shram Suvidha Portal has been envisaged as a single point of contact between employer, employee and enforcement agencies bringing in transparency in their day-to-day interactions. Unique Labour Identification Number (LIN) is allotted to units to facilitate online registration. A common form for both ESIC and EPFO registration has been introduced under said portal. Registration of employers under ESI and EPF Act is fully online, without requirement of submission of any physical application documents either before the registration or after it. Government has dispensed away with all employer codes being issued by separate labour enforcement agencies such as ESIC, EPFO, CLC(C) and DGMS etc. and replaced them with new Labour Identification Number (LIN).LIN is a unique 10-digit number issued by the Ministry of Labour and Employment. The ID cards like Aadhaar Number, Driving License, Insured Person No., Pan, Passport No, UAN, and Voter Id No act as identifier.

## Registration of Employee

On joining the organization, an employee has to register in ESIC Portal.

- Once signing up with required details, the employee will receive a on his registered mail ID confirming user ID and password provided.
- The employee shall login with user ID and password and fill up the new registration form.
- The employee shall state details of Organisation and employer. Once all the information, the form be submitted to complete the registration.
- have been provided to fill the Declaration form i.e., Form-1 along with a copy of the family photo which the employer will be submitting at the ESI branch office.
- An employee is registered only after he makes advance payment for the next six months on clicking the payment option.
- Once registered, the employee will receive the c-11 letter, which is the registered letter containing his unique registration number of 17 digits generated by the ESIC system portal.
- Once registered, the registration can be transferred if the employee switches the organization and takes up employment elsewhere.

## EMPLOYEE PROVIDENT FUND MEANING AND REGISTRATION PROCEDURE

In order to provide financial stability and security in the form of post-retirement benefits and insurance to the employees engaged in organized sector when they are temporarily or no longer fit to work, the Parliament enacted the Employee's Provident Fund Scheme (EPFS). A tri-partite Board known as the Central Board of Trustee, Employee's provident Fund consisting of representatives of government (both Central and State), Employers and Employees manages these funds, and employees are required to contribute a part of their salary to it every month during their employment tenure.

| Compulsory Registration | Voluntary Registration |
|---|---|
| Registration under Employees Provident Fund, 1952 is mandatory for an establishment:<br>i. which is a factory engaged in any industry having 20 or more persons, and<br>ii. to any other establishment employing 20 or more persons or class of such establishments which the Central Government may, by notification specify on this behalf. | However, an establishment with less than 20 employees can voluntarily opt for PF registration to protect employee's benefits |

The employer must obtain the registration within 1 month of touching mandatory registration threshold.

As an ease of doing business initiative, the Government of India launched a unified portal labour and employment "Shram Suvidha Portal" to facilitate Establishments, Contractors,

Employers or Principal Employers to submit application for Registration/License under Labour Laws Online i.e.,

(1) The Employees Provident Funds and Miscellaneous Provision's Act (EPF) Act, 1952.
(2) Employees' State Insurance Act (ESI) Act, 1948.
(3) Contract Labour (Regulation and Abolition) Act, 1970.
(4) Building and Other Construction Workers (BOCW) Act, 1996.
(5) Inter-State Migrant Workmen (ISMW) Act, 1979.

License:

1. CLRA Act
2. ISMW Act

Unified Shram Suvidha Portal is the official portal of Ministry of Labour and Employment, Government of India with objective of single window access for Registration or Licensing related services of Employers/Establishments and other stakeholders. The registration process for employer for EPF is same as provided under ESI registration.

Every employee is issued Universal Account number by EPFO towards the contribution to EPF. UAN is a 12-digit unique identification number for lifetime irrespective of the change in the organisation. UAN allows Employee to connect all his provident fund accounts across the organisations on a single platform on UAN Login portal.

Registration for EPFO & ESIC for new Public & Private Limited Companies and One Person Company has been stopped on Shram Suvidha Portal from 15.02.2020. With effect from 15.02.2020, new Public & Private Limited Companies and One Person Company shall get registration number for EPFO & ESIC on MCA portal (www.mca.gov.in through Spice+ and AGILE-PRO forms only at the time of incorporation.

However, the above new companies will have to comply with the provisions of EPF & MP Act, 1952, and ESI Act, 1948 when they cross the threshold limit of employment under the respective Acts.

## POLLUTION CONTROL

Entrepreneurs are required to obtain Statutory clearances relating to Pollution Control and Environment for setting up an industrial project, for 39 types of projects as listed, environmental clearance needs to be obtained from the Ministry of Environment, Forest and Climate Change, (MoEFCC) Government of India. This list includes industries like petrochemical complexes, petroleum refineries, cement, thermal power plants, bulk drugs, fertilizers, dyes, paper etc.

State Pollution Control Board is the concerned authority to obtain a pollution license/Certificate or a consent to establish such business. The permission is obtained in two stages:

**1)** Consent to establish (CTE)
- To be obtained prior to commencement of construction or any similar activities to start the business.
- License valid for a period 1 to 7 years according to request made by Project Developers/ Designers/Investors.

**2)** Consent to operate (CTO)
- To be applied and obtained before starting production activity on the Unit.

- CTO License valid for a period of 5 years, which may vary State to State.

The Central Pollution Control Board has specified list of industries as requiring a pollution license.

The MoEFCC recategorized the industries based on Range of Pollution Index and grouping of Industrial Sectors based on use of Raw Materials, manufacturing Process adopted and pollutants likely to be generated as follows:

| Category | Pollution Index Score (PSI) | Number of Industries |
|---|---|---|
| Red Category | Industrial Sectors having PSI of 60 and above | 60 |
| Orange Category | Industrial Sectors having PSI of 41 to 59 | 83 |
| Green Category | Industrial Sectors having PSI of 21 to 40 | 63 |
| White Category | Industrial Sectors having PSI incl and upto 20 | 36 |

Industries were categorized under red, orange and green category are covered under consent management for obtaining Consent to Establish (CTE) and Consent to Operate (CTO) under Water Act, 1974 and Air Act, 1981.

Industries which fall under white category are exempted from environment clearance and obtaining consent under Water (Prevention & Control of Pollution) Act, 1974, Air (Prevention & Control of Pollution) Act, 1981.

Industries and business under white category need to self-govern themselves and need to intimate various State Pollution Control Board (SPCB) within 30 days of commencement of their business.

The White Category of industries has to however satisfy these conditions to be eligible for this pollution license exemption: -

a. The industry is being established in the locality demarcated for them.
b. Their investment in the industry is not more than Rs. One Crore on plant and machinery.
c. There will not be any discharge of trade effluent from the industry into stream or well or sewer or onto land and/or that industry will not discharge any air pollution including noise into the atmosphere.
d. The industry will not discharge any toxic/hazardous wastes and will not handle any toxic/hazardous chemicals.

**Procedure for obtaining NOC from Pollution Control Board:**

1. The application for consent to establish (CTE) and consent to operate (CTO) can now be made online by logging onto concerned State's pollution control board's website.
2. State pollution control board need to reply within 4 months. Due diligence is carried out by pollution authority of the business premises and pollution.
3. NOC application is either accepted or rejected. If application is accepted for NOC, then a certificate is issued to business. However, if application is rejected by pollution control board, then applicant need to be intimate with reason for the same.

If an individual fails to obtain a CTE/CTO or Pollution license, they will be subject to 6 months to 1 year of imprisonment, with chances of a 6-year extension and penalty charges.

## COMPLIANCES UNDER ENVIRONMENT LAWS

Compliance under environment laws are:

- EC (Environment Clearances)
- FC (Forest Clearance)
- WC (Wild Life Clearance)
- CTE (Consent to Establish)
- CTO (Consent to Operate)
- Authorization (Waste Management & Hazardous and Other Wastes (Management And Transboundary Movement) Rules
- HSM ( Hazardous Substance Management)

### Environmental Laws & Applicable Regulatory Authorities

| NOC/PERMISSIONS | REGULATORY AUTHORITY | APPLICABLE ACTS |
|---|---|---|
| EC (Environmental Clearances) | MoEF&CC, SEIAA | Environmental Protection Act, 1986 |
| FC (Forest Clearance), Tree felling | MoEF&CC, Forest Department | Forest Act, |
| WC (Wildlife Clearance) | MoEF&CC, Wildlife division | Wildlife Act |
| CTE/CTO/Authorisation/Battery/ Plastic/Noise/BMW | CPCB/SPCB | Air, Water, Noise, MSW, Plastic, Battery act |
| HSM | MoEF&CC, DGFASLI | MSIHC rules |
| Water Abstraction/dewatering | CGWA/CGWB/Ministry of water resources | CGWA act |

### OTHER REGISTRATION AS PER REQUIREMENT OF SECTOR/ ACTIVITIES

Sector based registrations

| Sector | Registration/License | Authority |
|---|---|---|
| Import and export for Goods and Services | IE Code | Director General for Foreign Trade |
| Setting up of Pharmacy Business | Drug License | Central Drugs Standard Control Organization and State Drugs Standard Control Organization |
| Regulating food Business | FSSAI | Food Safety and Standards Authority of India |

| | | |
|---|---|---|
| For Non-Bank Finance Activity | Non-Bank Finance Company Registration | Reserve Bank of India |
| Banking Activities | Banking Licence | Reserve Bank of India |
| Insurance Activities | IRDAI Registration | Insurance Regulatory and Development Authority of India |
| Industrial Activities | Industrial Activities | Department for Promotion of Industry and Internal Trade |
| Telecom Services | Telecom license | Ministry of Communications and Information Technology |

## IMPORT EXPORT CODE

Import Export Code (IE Code) is a key business identification number which is mandatory for exporting or importing goods. It is a 10-digit code which is issued by the Directorate General of Foreign Trade (DGFT), Ministry of Commerce and Industry. However, for services exports, IEC shall be not be necessary except when the service provider is taking benefits under the Foreign Trade Policy.

IE code has lifetime validity. Importers are not allowed to proceed without this code and exporters can't take benefit of exports from DGFT, customs, Export Promotion Council, if they don't have this code.

The IE Code must be quoted by importers while clearing customs. Also, banks require the importers IE Code while sending money abroad. For exporters, IE Code must be quoted while sending shipments. And banks require the exporters IE Code while receiving money from abroad.
The nature of the firm obtaining an IEC may be any of the follows- "Proprietorship, Partnership, LLP, Limited Company, Trust, HUF and Society." Consequent upon introduction of GST, IEC number is the same as the PAN of the firm. The IEC would be separately issued by DGFT.

**Application for IE Registration**

Process to apply for Importer Exporter Code (IEC) on the DGFT portal (https://dgft.gov.in)

**a)** Valid Login Credentials to DGFT Portal (After Registering on DGFT Portal).

**b)** User should have an active Firms Permanent Account Number (PAN) and its details like Name as per PAN, Date of Birth or Incorporation.

**Note:** These details will be validated with the Income Tax Department site.

**c)** Scanned Documents for Upload in the System (PDF Only and Max file size of 5 MB).

i. Proof of establishment/incorporation/registration.

- Partnership
- Registered Society
- Trust
- HUF
- Others

ii. Proof of Address can be any one of the following documents:
   I. Sale Deed, rent agreement, lease deed, electricity bill, telephone land line bill, mobile, postpaid bill, MoU, Partnership deed;
   II. Other acceptable documents (for proprietorship only):Aadhar card, passport, voter id;
   III. In case the address proof is not in the name of the applicant firm, a no objection certificate (NOC) by the firm premises owner in favor of the firm along with the address proof is to be submitted as a single PDF document.

iii. Proof of Firm's Bank Account
   - Cancelled Cheque
   - Bank Certificate

iv. User should have an active DSC or Aadhaar of the firm's member for submission.

v. Active Firm's Bank account for entering its details in the Application and to make online payment of the application fee.

## DRUG LICENSE

A Drug License is permission to start a pharmacy business. Drug comprises of medications and instruments used for diagnosis, treatment and prevention of any disorder or disease in animals and human beings. The Central Drugs Standard Control Organization and State Drugs Standard Control Organization control the issue of drug license under Drugs and Cosmetics Act, 1940.

Drug license for setting up a pharmacy business is usually under the purview of the State Drugs Standard Control Organization. The applicant shall visit respective state website for obtaining such license.

### Classification of Drug License

Normally, the Drug Control Organization issues two types of licenses for operating a pharmacy business.

(i) One is the Retail Drug License (RDL) issued to run a general chemist shop.
(ii) The other is the Wholesale Drug License (WDL) issued to persons or agencies engaged in drugs and medicines.

In most states, a retail drug license is only issued to persons who possess a degree or diploma in pharmacy from a recognized institute or university after depositing the requisite fee. But this condition is relaxed in case of procuring a Wholesale Drug license (WDL).

### Prerequisites for obtaining Drug License

The following are minimum requirements for obtaining drug license or starting a pharmacy in India:

- **Area:** The minimum area of 10 square meter is required to start a medical shop or pharmacy or wholesale outlet. In case, the pharmacy business combines retail and wholesale, a minimum of 15 square meter is required.
- **Storage Facility:** The store must have refrigerator & air conditioner in the premises. According to the labelling specifications certain drugs like vaccines, sera, insulin injections etc., are required to be stored in the refrigerator.
- **Technical Staff:**

(a) **Wholesale** – The sale of drug by wholesale shall be made either in the presence of registered pharmacist or in the presence of a competent person who shall be a graduate with 1 year experience in dealing in drugs or a person who has passed S.S.L.C with 4years experience in dealing in drugs, specially approved by the department of drug control for the purpose.

(b) **Retail** – The sale of drug by retail must be made in the presence of registered pharmacist approved by the department, registered pharmacist is required throughout the working hours.

**Documents required for obtaining Drug License**

The documents required for starting a pharmacy business varies from state to state. However, the following is an indicative list of documents required for obtaining drug license in India:

a. Application form in the prescribed format
b. Covering Letter with the intent of the application signed with name and designation of the applicant
c. Challan of fee deposited for obtaining drug license
d. Declaration form in the format prescribed
e. Key plan (Blue print) for the premises
f. Site plan (Blue print) for the premises
g. Basis of possession of the premises
h. Proof of ownership of the premises, if rented
i. Proof of constitution of the business (Incorporation Certificate / MOA / AOA / Partnership Deed)
j. Affidavit of non-conviction of proprietor / partners/ directors under Drugs and Cosmetics Act, 1940
k. Affidavit of registered pharmacist or competent person working full time
l. Appointment letter of registered pharmacist/competent person, if employed person.

## FSSAI

FSSAI is an acronym for Food Safety and Standards Authority of India. Food Safety and Standards Authority of India (FSSAI), is an autonomous body created at central level to regulate food-related issues in India. FSSAI was established, in August 2011, to ensure the safety and wholesomeness of articles of food. FSSAI was created under the provisions of the Food Safety and Standards Act, 2006, with guidelines from the Ministry of Health and Family Welfare, and the Central government. The purpose is to lay down standards that are backed by science. To regulate the manufacture, storage, distribution, sale, and import. The aim is to protect and promote public health through various regulations and supervision of food processes.

As per section 3(1) of food safety and Standards act,2006, every food business operator in India is required to be licensed under Food Safety &Standards Authority of India. All the manufacturers, traders, restaurants who are involved in food business must obtain a 14-digit registration or a license number which must be printed on food packages.

This step is taken by government's food licensing & registration system to ensure that food products undergo certain quality checks, thereby reducing the instances of adulteration, substandard products and improve accountability of manufacturers by issuing food service license. FSSAI Online Registration is done through office website of FSSAI for basic and

central level i.e., https://foscos.fssai.gov.in. For state, the FSSAI registration is also done through offline mode.

The registration and licensing of food business in India is governed by the Food safety and Standards (Licensing and Registration of Food businesses) Regulation, 2011. As per the regulation, all food business operator in India must have a FSSAI registration or license if they are involved in the manufacturing, storage, transportation or distribution of food products. Based on the size a nature of business, FSSAI registration or FSSAI license may be required.

## FSSAI Registration

FSSAI registration is required for all petty food business operators. Petty food business operator is any person or entity who:

(a) Manufactures or sells any article of food himself or a petty retailer, hawker, itinerant vendor or temporary stall holder; or
(b) Distributes foods including in any religious or social gathering except a caterer; or
(c) Other food businesses including small scale or cottage or such other industries relating to food business or tiny food businesses with an annual turnover not exceeding Rs 12 lakhs and whose:
    - Production capacity of food (other than milk and milk products and meat and meat products) does not exceed 100 kg/ltr per day or
    - Procurement or handling and collection of milk is up to 500 litres of milk per day or
    - Slaughtering capacity is 2 large animals or 10 small animals or 50 poultry birds per day or less.

A producer of milk who is a registered member of a dairy Cooperative Society registered under Cooperative Societies Act and supplies or sells the entire milk to the Society shall be exempted from for registration.

Petty food business operators are required to obtain a FSSAI registration by submitting an application for registration in Form A or by applying online on the FoSCoS portal. On submission of a FSSAI registration application, the registration should be provided or application rejected in writing within 7 days of receipt of an application by authority.

FSSAI registration certificate contains the details of registration and a photo of the applicant. The certificate must be prominently displayed at the place of food business, at all times while carrying on the food business.

## FSSAI License

Any person or entity that is not classified as a petty food business operator is required to obtain a FSSAI license for operating a food business in India. FSSAI license is of two types:

(i) **State FSSAI License:** FSSAI State License is needed for small to medium sized Food Companies which has an annual turnover of Rs. 12 Lakhs – Rs. 20 Crores. State FSSAI license is required for medium sized food manufacturers, processor and transporters.
(ii) **FSSAI Central License:** It is mandated for all Food giants with an annual turnover of more than Rs. 20 Crores. Based on the size and nature of the business, the

licensing authority would change. Large food manufacturer/ processors/transporters and importers of food products require central FSSAI license.

The fee and procedure for obtaining a FSSAI license is more extensive when compared to a FSSAI registration.

FSSAI license application should be made in Form B by applying online on the FoSCoS portal along with the necessary self-attested declaration, affidavit and annexures, as applicable. Fee for the State is dependent on respective state rules.

FSSAI license in 'Form C' is granted for a period of 1 to 5 years as request by the food business operator. Higher fee would be applicable for obtaining FSSAI license for more years. If registration is obtained for one or two years, then the license can be renewed by making an application, no later than 30 days prior to the expiry date of the FSSAI license.

## NON-BANK FINANCE COMPANY REGISTRATION

A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act,2013 or previous company law of 1956 that is engaged in the business of loans and advances, receiving deposits (some NBFC's only), acquisition of stocks or shares, leasing, hire-purchase, insurance business, chit business. Therefore, NBFCs are doing functions similar to Banks but they differ from Banks which are as follows:

**Differences between banks and NBFCs:**

a) NBFC cannot accept demand deposits,
b) NBFCs cannot issue cheques drawn on itself, and
c) NBFC depositors are not covered by the Deposit Insurance and Credit Guarantee Corporation.

**Requirement of NBFC License with RBI**

In terms of Section 45-IA of the RBI Act, 1934, Non-Banking Financial Companies which are conducting financial activity as principal business which include lending or acquisition of shares, stocks, bonds, etc., or financial leasing or hire purchase or accepting deposits shall not commence or carry-on business of a non-banking financial institution without obtaining a certificate of registration from the Bank and without having a Net Owned Funds of INR 200 Lakhs .

**Financial activity as principal business**

- When a company's financial assets (cash and cash equivalents, debtors, securities, cash in bank etc.) constitute more than 50 per cent of the total assets
  (and)
- income from financial assets constitute more than 50 percent of the gross income.

A company which fulfills both these criteria must have NBFC to be taken from RBI u/s 45-IA of the RBI Act of 1934.

This test for NBFC license is popularly known as the 50-50 test.

Therefore, companies engaged in agricultural operations, industrial activity, purchase and sale of goods, providing services or purchase, sale or construction of immovable property as their principal business and are doing some financial activity in a small way, will not require NBFC registration.

## Financial Companies exempt NBFC License

The following types of entities that are involved in the principal business of financial activity do not require NBFC License from RBI:

- Housing Finance Companies – Regulated by the National Housing Bank;
- Insurance Companies – Regulated by Insurance Regulatory and Development Authority of India (IRDA);
- Stock Broking – Regulated by Securities and Exchange Board of India;
- Merchant Banking Companies – Regulated by Securities and Exchange Board of India;
- Venture Capital Companies – Regulated by Securities and Exchange Board of India;
- Companies that run Collective Investment Schemes – Regulated by Securities and Exchange Board of India;
- Mutual Funds – Regulated by Securities and Exchange Board of India;
- Nidhi Companies – Regulated by the Ministry of Corporate Affairs (MCA);
- Chit Fund Companies – Regulated by the respective State Governments.

The above types of companies have been exempted from NBFC registration requirements and NBFC regulations of RBI as they are regulated by other financial sector regulators.

Mortgage Guarantee Companies have been notified as Non-Banking Financial Companies under Section 45 I(f)(iii) of the RBI Act, 1934. Core Investment Companies with asset size of less than Rs. 100 crore, and those with asset size of Rs. 100 crore and above but not accessing public funds are exempted from registration with the RBI.

## Requirement for Obtaining NBFC License

To apply and obtain NBFC License, the following are the basic requirements:

- It shall be a company registered in India (Private Limited Company or Limited Company);
- The company must have minimum Net Owned Fund of Rs. 200 lakhs.

## Calculating Net Owned Funds as per RBI Definition

Net Owned Funds Formula

- The Net Owned Funds would be calculated based on the last audited balance sheet of the Company.
- Net owned Fund will consist of paid-up equity capital, free reserves, balance in share premium account and capital reserves representing surplus arising out of sale proceeds of assets but not reserves created by revaluation of assets. From the aggregate of items will be deducted accumulated loss balance and book value of intangible assets, if any, to arrive at owned funds. Further, investments in shares of other NBFCs and in shares, debentures of subsidiaries and group companies in excess of ten percent of the owned fund mentioned above will be deducted to arrive at the Net Owned Fund.

**Net owned funds:**

Paid up equity capital + free reserves+ balance in share premium account +capital reserves representing surplus arising out of sale proceeds of assets (not created by revaluation of assets)

(-) accumulated losses

(-) book value of intangible assets

(-) investments in shares of other NBFCs and in shares, debentures of subsidiaries and group companies in excess of ten percent of the owned fund mentioned above

## Types of NBFC License

Before applying for NBFC License, the type and category of NBFC license must first be determined. NBFCs are categorized

a. in terms of the type of liabilities into
   (i) Deposit accepting NBFCs and
   (ii) Non-Deposit accepting NBFCs
b. non deposit taking NBFCs by their size into
   (i) systemically important (NBFC-NDSI ) and
   (ii) other non-deposit holding companies (NBFC-ND) and
c. by the kind of activity, they conduct.

## Applying for NBFC License

The application for NBFC License must be submitted online at XBRL website https://xbrl.rbi.org.in and offline with the necessary documents to the Regional Office of the Reserve Bank of India. The following are the documents that need to be submitted for NBFC License:

- Information about the management.
- Certified copies of Certificate of Incorporation and Certificate of Commencement of Business in case of public limited companies.
- Certified copies of up-to-date Memorandum and Articles of Association of the company. Details of clauses in the memorandum relating to financial business.
- Copy of PAN/CIN allotted to the company.
- Directors' profile, separately filled up and signed by each director.
- Certificate from the respective NBFC/s where the Directors have gained NBFC experience.
- CIBIL Data pertaining to Directors of the company.
- Financial Statements of the last 2 years of unincorporated Bodies, if any, in the group where the directors may be holding directorship with/without substantial interest.
- Board Resolution specifically approving the submission of the application and its contents and authorizing signatory.
- Board Resolution to the effect that the company has not accepted any public deposit, in the past (specify period)/does not hold any public deposit as on the date and will not accept the same in future without the prior approval of Reserve Bank of India in writing.
- Board resolution stating that the company is not carrying on any NBFC activity/stopped NBFC activity and will not carry on/commence the same before getting registration from RBI.
- Certified copy of Board resolution for formulation of "Fair Practices Code".
- Statutory Auditors Certificate certifying that the company is/does not accept/is not holding public deposit.
- Statutory Auditors Certificate certifying that the company is not carrying on any NBFC activity.
- Statutory Auditors Certificate certifying net owned fund as on date of the application.

- Details of Authorized Share Capital and latest shareholding pattern of the company including the percentages.
- Copy of Fixed Deposit receipt & bankers' certificate of no lien indicating balances in support of Net Owned Funds.
- Details of the bank balances/bank accounts/complete postal address of the branch/bank, loan/credit facilities etc. availed.
- Last three years Audited balance sheet and Profit & Loss account along with directors & auditors report or for such shorter period as are available (for companies already in existence).
- Business plan of the company for the next three years giving details of its (a) thrust of business, (b) market segment and (c) projected balance sheets, cash flow statement, asset/income pattern statement without any element of public deposits.
- Source of the startup capital of the company substantiated with documentary evidence.
- Self-attested Bank Statement/IT returns etc.
- In addition to the above documents, more documents may be required as per the RBIs requirement for NBFC License.

## BANKING

Licensing of Banking Companies is governed by Banking Regulation Act, 1949. To be registered as a banking company, the entity must be a company registered under the Companies Act, 2013 or previous company laws or a foreign company having the prescribed minimum paid up capital.

The minimum paid-up voting equity capital for a bank shall be 500 Crore Rupees for universal banks and 200 Crore Rupees for small finance banks. And any addition to this capital will be based upon the plan presented by the promoters of the bank to the RBI.

According to Section 12 of the Banking Regulation Act, 1949, no banking company is allowed to carry on its business unless it satisfies the following conditions:

1. Its subscribed capital is not less than one-half of its authorized capital;
2. Its paid-up capital is not less than one-half of the subscribed capital;
3. The capital of the company consists of ordinary shares, equity shares and preference shares:

   Provided that the issue of preference share shall be in accordance with the guidelines framed by the Reserve Bank specifying the class of preference shares, the extent of issue of each class of such preference shares (whether perpetual or irredeemable or redeemable), and the terms and conditions subject to which each class of preference shares may be issued:

4. No person holding shares in a banking company shall have voting rights of above 10% of total voting rights of all the shareholders;
5. Every managing executive of the bank needs to disclose, to the RBI, the extent and the amount of his shareholding in the firm.

Section 22 of the Act details on licensing of Banking Companies which states as below:

1. Save as hereinafter provided, no company shall carry on banking business in India unless it holds a license issued in that behalf by the Reserve Bank and any such license may be issued subject to such conditions as the Reserve Bank may think fit to impose.

2. Every company before commencing banking business shall apply in writing to the Reserve Bank for a license under this section.
3. Before granting any license under this section, the Reserve Bank may require to be satisfied by an inspection of the books of the company or otherwise that the following conditions are fulfilled, namely: -
   a. that the company is or will be in a position to pay its present or future depositors in full as their claims accrue;
   b. that the affairs of the company are not being, or are not likely to be, conducted in a manner detrimental to the interests of its present or future depositors;
   c. that the general character of the proposed management of the company will not be prejudicial to the public interest of its present or future depositors;
   d. that the company has adequate capital structure and earning prospects;
   e. that the public interest will be served by the grant of a license to the company to carry on banking business in India;
   f. that having regard to the banking facilities available in the proposed principal area of operations of the company, the potential scope for expansion of banks already in existence in the area and other relevant factors the grant of the license would not be prejudicial to the operation and consolidation of the banking system consistent with monetary stability and economic growth;
   g. any other condition, the fulfilment of which would, in the opinion of the Reserve Bank, be necessary to ensure that the carrying on of banking business in India by the company will not be prejudicial to the public interest or the interests of the depositors.
4. Before granting any license under this section to a company incorporated outside India, the Reserve Bank may require to be satisfied by an inspection of the books of the company or otherwise that the conditions specified in sub-section (3) are fulfilled and that the carrying on of banking business by such company in India will be in the public interest and that the government or law of the country in which it is incorporated does not discriminate in any way against banking companies registered in India and that the company complies with all the provisions of this Act applicable to banking companies incorporated outside India.

## IRDA (INSURANCE REGULATORY AND DEVELOPMENT AUTHORITY)

### Introduction

Till 1999 the insurance sector was controlled by Controller of Insurance as per the provisions of Insurance Act 1938 but after formation of the IRDA it was felt by the Authority that the most of the provisions of this Act were irrelevant in the present scenario of the country. Therefore, the Authority issued various regulations, as deemed fit, to develop the insurance sector in the country. Registration of Insurance company in India is governed by the Insurance Regulatory and Development Authority (Registration of Indian Insurance Companies) Regulations, 2000.

**Insurance Regulatory and Development Authority (Registration of Indian Insurance Companies) Regulations, 2000.**

**Classes of insurance business for which requisition for registration application may be made:**

1. The classes of business of insurance for which requisition for registration application may be made are:
   (i) Life insurance business;
   (ii) General insurance business;
   (iii) Health insurance business exclusively;
   (iv) Reinsurance business.
2. An applicant means a public company registered and incorporated under the Companies Act, 2013 or a statutory body established by an Act of Parliament to carry on insurance business and applies to IRDAI for registration as an Indian insurance company.
3. An applicant shall make a requisition for registration application under regulation 3 either for Life Insurance or General Insurance Business or Health Insurance Business exclusively or Reinsurance Business.
4. Capital Requirement
   a. The minimum equity capital requirement to set up a Life, General or Health Insurance Company is INR 100 crore;
   b. in case of a Reinsurance company, the requirement is a minimum of INR 200 crore.

**Who cannot apply for Registration under IRDA:**

An applicant shall not be eligible to apply for the requisition in the following circumstances:

a. Where the requisition for registration application has been rejected by the Authority or withdrawn; or
b. where the foreign investors or Indian Promoter of the existing venture have exit for any reason at any time during the preceding two financial years from the date of requisition for registration application; or
c. Where application for registration has been rejected by the Authority or withdrawn by the applicant for any reason at any time during the preceding two financial years from the date of requisition for registration application; or
d. Where Certificate of Registration has been cancelled by the Authority; or
e. Where the name of the applicant does not contain the words 'insurance' or 'assurance'.

**Procedure of registration of an Insurance Company is specified in Insurance Regulatory and Development Authority (Registration of Indian Insurance Companies) Regulations, 2000 (Amended upto 8th June, 2020)**

1. **Application in FORM IRDAI/R1 (Regulation 3)**
   - An applicant desiring to carry on insurance business shall make an application to the Authority for issuance of requisition for registration application form IRDAI/R1.
   - The Authority may require the applicant to furnish further information or clarifications regarding the matters relevant to the consideration of the application for issuance of requisition for registration application.
   - The Authority, by recording the reasons in writing, may reject the application for issuance of requisition for registration application Form IRDAI/R1.
   - An applicant aggrieved by the decision of the Authority may, within a period of thirty days from the date of such communication, appeal to the Securities Appellate Tribunal.
2. **Documents to be attached with FORM IRDAI/R1**

Every requisition for registration application shall be accompanied by—

(i) a certified copy of the Memorandum of Association and Articles of Association, where the applicant is a company and incorporated under the Companies Act, 2013 or a certified copy of the Act of Parliament setting up the statutory body to carry on insurance business;
(ii) the name, address and the occupation of the directors;
(iii) a certified copy of the annual report of Indian Promoters and the Foreign Investors for the last five years preceding the year of filing of requisition of registration application;
(iv) a certified copy of the shareholders' agreement between Indian Promoters and Foreign Investors of the applicant;
(v) Projection of Business for 5 years duly approved by the Board of Directors of the applicant.

**Furnishing of further information and clarification, etc.**

The Authority may require the applicant, which makes such requisition, to furnish further information or clarification regarding the matters relevant to consider the requisition for registration application.

**3. Application in Form IRDAI/R2 for grant of certificate of registration**

The Authority on being satisfied with the information submitted and on verification that-

a. the requisition in Form IRDAI/R1 is complete in all respects and is accompanied by all documents required therein; and
b. the applicant shall carry on all functions in respect of the insurance business including management of investments within India as may be specified;

An applicant, whose requisition for registration application has been accepted by the Authority, shall make an application in Form IRDAI/R2 for grant of certificate of registration.

**Every such application shall be accompanied by-**

a. evidence of having rupees one hundred crore or more paid-up equity share capital, in case the application for grant of certificate is for life insurance business or general insurance business or health Insurance business;
b. evidence of having rupees two hundred crore or more paid-up equity share capital, in case the application for grant of certificate is for re-insurance business;
c. an affidavit by the promoters and foreign investors of the applicant certifying that the requirements of the second proviso to section 6(1) of the Act to the effect that paid-up share capital is adequate after excluding any preliminary expenses of the company have been satisfied;
d. a statement indicating the distinctive numbers of shares issued to each Indian promoter and Investors in respect of share capital of the applicant;
e. an affidavit by the managing director, chief executive officer or whole-time director of the Indian promoters and the foreign investors of the applicant certifying that the holding of foreign paid-up equity capital is calculated in manner specified above and does not exceed 74% of the total paidup capital of the applicant company;

Provided that in case of the Indian promoter being Limited Liability Partnership such affidavit shall be signed by the Designated Partner.

f. Where the foreign direct investment is more than 26 percent, a certified copy of the approval given by FIPB in accordance with Indian Insurance Companies (Foreign Investment) Rules, 2015;
g. a certified copy of the published prospectus, if any;
h. a certified copy of the standard forms of the insurer and statements of the assured rates, advantages, terms and conditions to be offered in connection with insurance policies together with a certificate by an actuary in case of life insurance business that such rates, advantages, terms and conditions are workable and sound;
i. a certified copy of the Memorandum of Understanding or Management Agreement or Shareholders Agreement or Voting Rights Agreements or any other agreements in whatsoever form entered into between the Indian promoters and the foreign investors, if any, or amongst the promoters as a whole including details of the support / comfort letters exchanged between the parties;
j. proof in support of payment of the non-refundable fee of rupees five lakh;
k. a certificate from a practising chartered accountant or a practising company secretary certifying that all the requirements relating to registration fees, equity share capital, and other requirements of the Act have been complied with by the applicant;
l. any other information required by the Authority during the processing of the application for registration

**Manner of payment of fee for registration**

The non-refundable fee of rupees five lakh for registration shall be remitted by a bank draft issued by any scheduled bank payable at Hyderabad or by any recognised electronic funds transfer to Insurance Regulatory and Development Authority of India.

**4. Grant of certificate of registration**

The Authority, after making such inquiry as it deems fit and on being satisfied, may register the applicant as an insurer for the class of business for which the applicant is found suitable and grant the applicant the certificate in Form IRDAI/R3.

Provided that the Authority may impose such conditions as may be deemed fit at the time of grant of the Certificate of Registration. The applicant shall be bound by the conditions subject to which the certificate in Form IRDAI/R3 has been issued.

**Commencement of Insurance Business:** An applicant granted the Certificate of Registration under the Regulations shall commence insurance business for which it has been authorised within 12 months of the date grant of Certificate of Registration.

Provided that if the company feels that it will not be in position to commence the insurance business within the specified period of 12 months, it can before the time limit expires, seek an extension, through a proper written application, to the Authority.

The Authority on receipt of the request will examine it and communicate its decision in writing, either rejecting the request or granting it. No extension of time shall be

granted by the Authority beyond 24 months from the date of grant of Certificate of Registration.

## INDUSTRY LICENSING POLICY

Section 11 of the Industries (Development and Regulation) Act, 1951 lays down condition of Licensing of new industrial undertakings as follows—

1. No person or authority other than the Central Government, shall, after the commencement of this Act, establish any new industrial undertaking, except under and in accordance with a license issued in that behalf by the Central Government:

   Provided that a Government other than the Central Government may, with the previous permission of the Central Government, establish a new industrial undertaking.

2. A license or permission under sub-section (1) may contain such conditions including, in particular, conditions as to the location of the undertaking and the minimum standards in respect of size to be provided therein as the Central Government may deem fit to impose in accordance with the rules, if any, made under section 30.

Section 11A of the Act makes it mandatory to obtain license for producing or manufacturing new articles. According to the section, the owner of an industrial undertaking not being the Central Government in respect of which a license or permission has been issued under section 11 shall not produce or manufacture any new article unless- he has had the existing license or permission amended in the prescribed manner.

Since the liberalization and deregulation of the Indian economy in 1991, most industries have been exempted from obtaining an industrial license to start manufacturing in India. Government attention is reserved only for those industries that may impact public health, safety, and national security.

**At present, industrial license is made compulsory only for the following:**

1. Industries retained under compulsory licensing: The following industries require compulsory license:
   - Alcoholics drinks
   - Cigarettes and tobacco products
   - Electronic aerospace and defence equipment
   - Explosives
   - Hazardous chemicals such as hydrocyanic acid, phosgene, isocyanides and dissociates of hydro carbon and derivatives
2. Manufacture of items reserved for small scale sector by larger units large or medium industries undertaking manufacture of items reserved for SSI units. The Government has reserved certain items for exclusive manufacture in the small-scale sector. Non-small-scale units can undertake the manufacture of items reserved for small scale sector, only after obtaining an industrial license. In such cases, the non-small-scale unit is required to undertake an obligation to export 50% of the production of SSI reserved items.
3. When the proposed location attracts locational restriction-

## Locational restrictions

Industrial undertakings to be located within 25 kms of the standard urban area limit of 23 cities having a population of 1 million as per 1991 census require an industrial license. Industrial license even in these cases is not required if

(i) a unit is located in an area designated as an industrial area before 1991; or
(ii) it is non-polluting industries such as electronics, computer software, printing and other specified industries.

To create a business and Investor friendly environment, DPIIT has developed G2B Portal as a Single Window System for receiving application of Industrial Entrepreneurs to file an Industrial Entrepreneurs Memorandum (IEM) as well as Industrial License under Industries (Development and Regulation) Act, 1951. Online filing has been made mandatory with effect from 15th May 2014. The online portal has the required authentication mechanisms for submitting IEM and IL applications.

- Previously, the application for registration was made to the Secretariat of Industrial Assistance (SIA), Department of Industrial Policy & Promotion (DIPP) along with a fee.
- Once the license is obtained, an industrial undertaking is eligible for the allotment of controlled commodities and for the issuance of an import license for goods required for its construction and operation.

The validity of all Industrial Licenses has been increased to three years, whether issued before or after 2nd July 2014. The licensee has to apply for extension of validity after three years, as applicable.

## Procedure to apply for Industrial License

1. All applications for Industrial License under IDR Act, 1951 can now be applied online on G2B Portal in Form FC-IL/FORM FC-IL - Composite form for Foreign Collaboration and Industrial License.
2. The Applications are scrutinized for their completeness. Information in respect of incomplete applications is sought from the applicants.
3. If the applications for grant of license are complete in all respect with necessary documents, DPIIT circulates them to concerned administrative ministries, Ministry of Home Affairs, Concerned State Government and other concerned agencies for their comments.
4. After receipts of Comments from the concerned Ministries/Agencies, files are processed and submitted to the Licensing committee for consideration.
5. Licensing committee can recommend for grant of license/rejection of proposal/deferment of the proposal, based on the comments received and deliberations in the Committee. After recommendation the approval of the Minister in charge of DPIIT is obtained for grant of licenses or otherwise.

## IEM (Industrial Entrepreneur Memorandum)

All industrial undertakings exempted from the requirements of industrial licensing under the Industries (Development and Regulation) Act (D&R), 1951 and having an investment in plant and machinery of Rs 50 Crore and above; and turnover of Rs. 250 crore and above, including Existing Units, New undertaking (NU) and New Article (NA), may file an IEM, i.e.,

"Form IEM" in the prescribed format 'Part A'. This is filed online by filing details as per 'Part A' of IEM through portal G2B.

**Confirmation for receipt of such information by this Department is known as 'IEM Acknowledgement.:**

All on-line applications filed through the portal are scrutinized in 'IEM Section' for verification related to 'Incorporation Certificate'; 'Memorandum of Article'; 'Article of Association', 'Master data', 'PAN' and 'Codes related to NIC & Administrative Ministry/Department etc. Once the above is verified and found correct; the Department electronically issues IEM Ack. to the applicant.

The Acknowledgement (Ack.) of the IEM which is given on the spot on prima facie evidence of not attracting the provisions of licensing, cannot, therefore, be construed as a clearance or approval to carry on an industrial activity contemplated in the IEM unless the provisions of statutes/regulations/notifications etc. issued by the Central or State Governments from time to time or any specific directions or Stay Orders issued by the Court/ competent authority relevant to such an activity, are also fully complied with, or in no way contravened, as the case may be.

All Industrial undertakings which had filed IEM are required to report commencement of commercial production and this is also filed on-line on the same portal by way of filing information as per prescribed form 'Part B' of the IEM after commencement of commercial production by the establishment; a copy of the related IEM Ack. Is required to be attached while filing this information on the portal.

Like 'Part A' Ack. of IEM, the Department also issues Ack. for 'Part B' through its portal.

## TELECOM LICENSE

Business entities which provide internet services or engaged in commercial communications i.e., call center, BPO, Tele-education, Tele-banking, tele networking, e-commerce and other IT enabled services who are catogerised as 'Other Service Providers'(OSP) under New Telecom Policy, 1999, must obtain a telecom license from Department of Telecommunication (DoT) under Ministry of Communications and Information Technology, Government of India. The telecom license entitles the entities to provide telecommunication services in India.

**OSP license shall be categorized into two types:**

1. Domestic OSP – OSP providing services to clients located within national boundaries of India
2. International OSP - OSP providing services to clients outside India

### Process

A company registered under the Companies Act, 2013 or under any other previous law i.e., the Companies Act,1956 or LLP registered under Limited Liability Act,2008 or Partnership Firm or organisations registered under Shops and establishment Act are eligible to obtain OSP license.

- To Obtain a OSP license, the Company or LLP shall file an Application in Form - 1 to the DoT through online on DoT portal.
- OSP license is a location specific and can have multiple registrations for each such site.
- An entity shall inform the change, if any in the point of presence. Point of presence is a location where OSP places equipment like Private Automatic Branch Exchange, Interactive

voice recording System etc. to act as an extension of its OSP centre for collecting, converting, carrying and exchanging the telecom traffic related to its services.

## Mandatory documents required for OSP License

- Certificate of Incorporation issued by ROC;
- Memorandum and Articles of Association;
- Copy of LLP Agreement;
- Board resolution Power of Attorney authorizing the Authorized signatory with attested signature;
- Resolution passed by all designated partners or Partners as per provisions of LLP Act;
- A Note on nature of business or activites of the proposed OSP;
- List of present directors of the Company;
- List of present designated partners of LLP;
- Present Shareholding pattern of the Company;
- Present Shareholding pattern of LLP.

All the documents must be certified with seal by company secretary or one of Directors or Statutory Auditors or public notary in case of Company.

All documents must be certified with seal by either designated partner or all partners or statutory Auditors or public notary in case of LLP.

The OSP license is valid for a period of 20 years and can be extended for further period of ten years from the expiry of twenty years.

State level Approval from the respective State Industrial Department.

## STATE LEVEL APPROVAL FROM THE RESPECTIVE STATE INDUSTRIAL DEPARTMENT

Apart from the registration and licences listed above, one has to seek state level approval (s) wherever it is applicable to one's business from the respective State Industries Department.

Various State Government have formulated Industrial Policy to create a conducive environment through an enabling Policy and regulatory framework to drive sustainable industrial growth in the State. States committed to simplify the processes and procedures and expedite project approvals and clearances. The Policy focusses on providing quality industrial infrastructure, creation of a large land bank, financial assistance to the private sector for development of industrial infrastructure and sustainable environmental protection.

# Chapter 13 : Constitution and Labour Laws

Under the Constitution of India, Labour is a subject in the Concurrent List and, therefore, both the Central and the State governments are competent to enact legislations subject to certain matters being reserved for the Centre.

## INTRODUCTION

The Constitution of a country is the fundamental law of the land. It is under this fundamental law that all other laws are made and executed. Every organ of the state, be it the executive or the legislative or the judiciary, derives its authority from the Constitution and there is no authority, no department or branch of the State, which is above the Constitution or has been vested with unrestricted powers by the Constitution.

The trinity of Indian Constitution i.e., the Preamble, the Fundamental Rights and Directive Principles of the State Policy embody the fundamental principles which provide guide to all legislations including the labour legislations.

## SOCIAL JUSTICE AND INDUSTRIAL LAWS

The Preamble of the Constitution highlights the concept of socio-economic justice, being the main objectives of the State required by the Constitution.

Article 38 of the Constitution provides the concept of social justice by providing that the State shall strive to promote the welfare of the people by securing and protecting, as effectively as it may, social order in which justice, social, economic and political shall inform all institutions of the national life.

In the economic sphere, social justice means opportunities in greater measure to the poor and the needy for the betterment of their social and economic conditions. "It does not mean making rich man poor in order to make poor men rich. It does not mean that all wealth should be shared equally provision of basic minimum to all in response to life and living facilities for promoting one's own values and manner worth are the essential contents of social justice." (K.N. Bhattacharya, Indian Plans, A Generalist Approach, (1963)).

### Industrial laws are socio-economic justice oriented

The concept of social justice is so innate and demonstrated in the industrial laws of our country. As proclaimed in the Preamble of the Constitution and the Directive Principles of State Policy, the industrial jurisprudence of the country is founded on the basic idea of socio-economic equality and its aim is to assist the removal of socioeconomic disparities and inequalities.

The concept of social justice is though not limited to any particular branch of legislation although it is more prominent and conspicuous in industrial laws and relations. Its scope is comprehensive and is founded to the basic ideals of social economic equality and it aims at assisting the removal of social economic disparities and inequalities of birth and the competing claims especially between the employers and workers by finding a just, fair and equitable solution to their human relation problem, so that peace, harmony and collection of the highest order prevails among them which may further the growth and progress of nations.

## CONSTITUTIONAL REMEDIES

The Constitution also envisages remedies for violation of fundamental rights. Article 32 and 226 of the Constitution confers writ jurisdiction on Supreme Court and High Courts respectively for enforcement and protection of fundamental rights of an individual.

Article 32 is itself a fundamental right. Apart from the writ jurisdiction under Article 32, the Supreme Court is envisaged with discretionary jurisdiction to entertain appeal by special leave under Article 136 from decree, sentence, or order passed by any court or tribunal in India. High Courts are vested with writ jurisdiction under Article 226 and the power of superintendence over all courts and tribunals under Article 227.

A person aggrieved by an award of the High Court can appeal to the Supreme Court under Article 132 if any constitutional question is involved or under Article 133 in civil appeal.

**Can a Trade Union move the High Court under Article 226 to redress the fundamental rights of its members?**

This issue was discussed by the Rajasthan High Court in Jaipur Division Irrigation Employees Union v. State of Rajasthan and others (1994). Here a large number of the employees of the irrigation department were declared surplus. The Union challenged it in this writ petition. The Single Bench held that the petition is not maintainable holding that the fundamental rights of the individual are not the rights of the union. On appeal, the Division Bench reversed it and sent back to the Single Bench for disposal of the writ petition in accordance with the merits of the case.

The traditional concept of locus standi underwent sweeping changes in the modern age of public action and public interest litigation. In the famous case of S.P. Gupta and Ors. v. President of India and Ors. (1982 SC) the question of locus standi was discussed and it was held that:

- where a legal wrong or a legal injury is caused to a person or to a determinate class of persons by reason of violation of any constitutional or legal right or
- any burden is imposed in contravention of any constitutional or legal provision or without authority of law or any such legal wrong or legal injury or illegal burden is threatened

and such person or determinate class of persons is by reason of poverty, helplessness or disability or socially or economically disadvantageous position, unable to approach the Court for relief,

any member of the public can maintain an application for an appropriate direction, order or writ in the High Court under Article 226 of the Constitution of India or in the Supreme Court under Article 32 of the Constitution of India seeking judicial redress for the legal wrong or injury caused to such person or determinate class of persons.

## FUNDAMENTAL RIGHTS AND INDUSTRIAL RELATIONS

Articles 12 to 35 of the Constitution pertain to Fundamental Rights of the people. The Indian Constitution guarantees essential human rights in the form of Fundamental Rights under Part III and also Directive Principles of State Policy in Part IV which are fundamental in the governance of the country. Freedom and civil rights granted to all under Part III have been liberally construed by various pronouncements of the Supreme Court.

Fundamental Rights must not be read in isolation but together with directive principles and fundamental duties. The need for protecting and safeguarding the interest of labour as human beings has been enshrined in Article 14, 16, 19, 21, 23 and 24 giving an idea of the conditions under which labour had to be for work.

## Article 14: Equality before law

Equality is one of the magnificent corner-stones of Indian Democracy. Article 14 of the Constitution of India reads as under:

"The State shall not deny to any person equality before the law or the equal protection of the laws within the territory of India."

Article 14 bars discrimination and prohibits discriminatory laws. The said Article is clearly in two parts:

- while it commands the State not to deny to any person 'equality before law',
- it also commands the State not to deny the 'equal protection of the laws'.

Equality before law prohibits discrimination. It is a negative concept. The concept of 'equal protection of the laws' requires the State to give special treatment to persons in different situations in order to establish equality amongst all. It is positive in character.

In the case of the Air India v. Nargesh Meerza (1981) Regulation 46 and 47 of Indian Airlines regulations was in question which provides that an air Hostess will retire from the service

- upon attaining the age of 35 years or
- on marriage within 4 years of Service or
- on first pregnancy,

whoever found earlier

but the managing director had the discretion that he may extend the age of retirement one year at a time beyond the age of retirement up to the age of 45 years at his option if an air hostess was found medically fit.

It was held by the court that the clauses regarding retirement and pregnancy of the regulation as unconstitutional and therefore struck down. The retirement of air hostess on the ground of pregnancy was unreasonable and arbitrary and it was in violation of Article 14 of the constitution law of India.

## Article 16: Equality of opportunity in matters of public employment

1. There shall be equality of opportunity for all citizens in matters relating to employment or appointment to any office under the State
2. No citizen shall, on grounds only of religion, race, caste, sex, descent, place of birth, residence or any of them, be ineligible for, or discriminated against in respect or, any employment or office under the State.
3. Nothing in this article shall prevent Parliament from making any law prescribing, in regard to a class or classes of employment or appointment to an office under the Government of, or any local or other authority within, a State or Union territory, any requirement as to residence within that State or Union territory prior to such employment or appointment

4. Nothing in this article shall prevent the State from making any provision for the reservation of appointments or posts in favour of any backward class of citizens which, in the opinion of the State, is not adequately represented in the services under the State
5. Nothing in this article shall affect the operation of any law which provides that the incumbent of an office in connection with the affairs of any religious or denominational institution or any member of the governing body thereof shall be a person professing a particular religion or belonging to a particular denomination.

Article 16 assures equality of opportunity in matters of public employment and prevents the State from any sort of discrimination on the grounds of religion, race, caste, sex, descent, place of birth, residence or any of them. This Article also provides the autonomy to the State to grant special provisions for the backward classes, under-represented States, SC & ST for posts under the State. Local candidates may also be given preference is certain posts.

In the case of Mewa Ram Kanojia vs. All India Institute of Medical Sciences and Ors. (AIR 1989 SC 1256), the Court observed: "The doctrine of 'Equal Pay for Equal Work' is not an abstract one, it is open to the State to prescribe different scales of pay for different posts having regard to educational qualifications, duties and responsibilities of the post. The principle of 'Equal Pay for Equal Work' is applicable when employees holding the same rank perform similar functions and discharge similar duties and responsibilities are treated differently. The application of the doctrine would arise where employees are equal in every respect but they are denied equality in matters relating to the scale of pay.

Commenting on the principle of 'Equal Pay for Equal Work', the court has observed: "While considering the question of application of principle of 'Equal Pay for Equal Work' it has to be borne in mind that it is open to the State to classify employees on the basis of qualifications, duties and responsibilities of the posts concerned. If the classification has reasonable nexus with the objective sought to be achieved, efficiency in the administration, the State would be justified in prescribing different pay scale but if the classification does not stand the test of reasonable nexus and the classification is rounded on unreal, and unreasonable basis it would be violative of Article 14 and 16 of the Constitution.

## Article 19(1)(c) of the Constitution: Right to form Association & Union

Article 19(1)(c) speaks about the Fundamental right of citizen to form an associations and unions. Under clause (4) of Article 19, however, the State may by law impose reasonable restrictions on this right in the interest of public order or morality or the sovereignty and integrity of India.

The right of association pre-supposes organization as an organization or permanent relationship between its members in matters of common concern. It thus includes the right to form companies, societies, partnership, trade union and political parties. The right guaranteed is not merely the right to form association but also to continue with the association as such. The freedom to form association implies also the freedom to form or not to form, to join or not to join, an association or union.

**In the case of Damyanti Naranga v. The Union of India, the court observed that:**

"The right to form association necessarily implies that the persons forming the society have also the right to continue to be associated with only those whom they voluntarily admit in the association. The right guaranteed by Article 19(1)(c) cannot be confined to the initial stage of forming an association. If it were to be so confined, the right would be meaningless because as soon as an association is formed, a law may be passed interfering with its composition so that the association formed may not be able to function at all. The right can be effective only if it is held to include within, it the right to continue the association with its composition as voluntarily agreed upon by the persons forming the association. And, Article 19(4), on the face of it, cannot be called in aid to claim validity for the Act.

## Article 21 of the Constitution: Right to Life

Article 21 of the constitution of India reads as:

"No person shall be deprived of his life or personal liberty except according to a procedure established by law."

Article 21 assures every person right to life and personal liberty. The term 'life' has been given a very expansive meaning. The term 'personal liberty' has been given a very wide amplitude covering a variety of rights which go to constitute personal liberty of a citizen. Its deprivation shall only be as per the relevant procedure prescribed in the relevant law, but the procedure has to be fair, just and reasonable.

The right to life enshrined in Article 21 has been liberally interpreted so as to mean something more than mere survival and mere existence or animal existence. It therefore includes all those aspects of life which go to make a man's life meaningful, complete and worth living.

In course of time, Article 21 has come to be regarded as the heart of Fundamental Rights. This liberal interpretation of Article 21 by judiciary has led to two very spectacular results within the last two decades, viz.:

1. Many Directive Principles which, as such, are not enforceable have been activated and have become enforceable.
   a) Right to livelihood
   b) Right to live with human dignity
   c) Right to medical care
   d) Health of labour
   e) Sexual harassment
   f) Right to health
   g) Economic Rights.
2. The Supreme Court has implied a number of Fundamental Rights from Art. 21.

**In the case of Olga Tellis & Ors v. Bombay Municipal Corporation, 1986 SC, the Court held:**

"As we have stated while summing up the petitioners' case, the main plank of their argument is that the right to life which is guaranteed by Article 21 includes the right to livelihood and since, they will be deprived of their livelihood if they are evicted from their slum and

pavement dwellings, their eviction is tantamount to deprivation of their life and is hence unconstitutional.

For purposes of argument, we will assume the factual correctness of the premise that if the petitioners are evicted from their dwellings, they will be deprived of their livelihood. Upon that assumption, the question which we have to consider is whether the right to life includes the right to livelihood. We see only one answer to that question, namely, that it does. The sweep of the right to life conferred by Article 21 is wide and far reaching. It does not mean merely that life cannot be extinguished or taken away as, for example, by the imposition and execution of the death sentence, except according to procedure established by law. That is but one aspect of the right to life. An equally important facet of that right is the right to livelihood because, no person can live without the means of living, that is, the means of livelihood. If the right to livelihood is not treated as a part of the constitutional right to life, the easiest way of depriving a person his right to life would be to deprive him of his means of livelihood to the point of abrogation. Such deprivation would not only denude the life of its effective content and meaningfulness but it would make life impossible to live. And yet, such deprivation would not have to be in accordance with the procedure established by law, if the right to livelihood is not regarded as a part of the right to life. That, which alone makes it possible to live, leave aside what makes life livable, must be deemed to be an integral component of the right to life. Deprive a person of his right to livelihood and you shall have deprived him of his life. Indeed, that explains the massive migration of the rural population to big cities.

They migrate because they have no means of livelihood in the villages. The motive force which people their desertion of their hearths and homes in the village is that struggle for survival, that is, the struggle for life. So unimpeachable is the evidence of the nexus between life and the means of livelihood. They have to eat to Live. Only a handful can afford the luxury of living to eat. That they can do, namely, eat, only if they have the means of livelihood. That is the context in which it was said by Douglas J. in Baksey that the right to work is the most precious liberty because, it sustains and enables a man to live and the right to life is a precious freedom. "Life" means something more than mere animal existence and the inhibition against the deprivation of life extends to all those limits and faculties by which life is enjoyed"

**In the case of D.K. Yadav v. J.M.A. Industries Ltd 1993, the court held:**

"Article 21 of the Constitution clubs life with liberty, dignity of person with means of livelihood without which the glorious content of dignity of person would be reduced to animal existence. When it is interpreted that the colour and content of procedure established by law must be in conformity with the minimum fairness and processual justice, it would relieve legislative callousness despising opportunity of being heard and fair opportunities of defence. The order of termination of the service of an employee/workman visits with civil consequences of jeopardising not only his/her livelihood but also career and livelihood of dependents. Therefore, before taking any action putting an end to the tenure of an employee/workman, fair play requires that a reasonable opportunity to put forth his case is given and domestic enquiry conducted complying with the principles of natural justice."

**In the case of Paschim Banga Khet Mazdoor Samity v. State of West Bengal (1996 SC):**

A mazdoor fell from a running train and was seriously injured. He was sent from one government hospital to another and finally he had to be admitted in a private hospital where he had to incur an expenditure of Rs. 17,000/- on his treatment. Feeling aggrieved at the indifferent attitude shown by the various government hospitals, he filed a writ petition in the Supreme Court under Art. 32.

The Court has ruled that: "the Constitution envisages establishment of a welfare state, and in a welfare state, the primary duty of the government is to provide adequate medical facilities for the people. The Government discharges this obligation by running hospitals and health centres to provide medical care to those who need them. Art. 21 imposes an obligation on the State to safeguard the right to life of every person. Preservation of human life is thus of paramount importance."

**In the case of Vishakha & Ors. v. State of Rajasthan (1997) whereby a woman was assaulted and harassed at her workplace, the Supreme Court observed:**

"Each such incident results in violation of the fundamental rights of 'Gender Equality' and the 'Right of Life and Liberty'. It is clear violation of the rights under Articles 14, 15 and 21 of Constitution. One of the logical consequences of such an incident is also the violation of the victim's fundamental right under Article 19(1)(g) 'to practice any profession or to carry out any occupation, trade or business'."

## Article 23 and Article 24: Right Against Exploitation

According to Article 23(1), traffic in human beings, begar, and other similar forms of forced labour are prohibited and any contravention of this provision shall be an offence punishable in accordance with law. Article 23(1) proscribes three unsocial practices, viz.,

(1) begar;

(2) traffic in human beings; and

(3) forced labour.

The term 'begar' means compulsory work without any payment. Begar is labour or service which a person is forced to give without receiving any remuneration for it.

Withholding of pay of a government employee as a punishment has been held to be invalid in view of Article 23 which prohibits begar. 'To ask a man to work and then not to pay him any salary or wages savours of begar. It is a Fundamental Right of a citizen of India not to be compelled to work without wages.' (Suraj v. State of Madhya Pradesh).

The expression 'traffic in human beings,' commonly known as slavery, implies the buying and selling of human beings as if they are chattels, and such a practice is constitutionally abolished.

The words 'other similar forms of forced labour' in Article 23(1) are to be interpreted ejusdem generis. The kind of 'forced labour' contemplated by the Article has to be something in the nature of either traffic in human beings or begar.

Under Article 23(2), the State can impose compulsory service for public purposes, and in imposing such service the State shall not make any discrimination on grounds only of religion, race, caste or class or any of them. The State may thus exempt women from compulsory

service for that will be discrimination on the ground of sex and this has not been forbidden by Article 23(2).

The Supreme Court has given an expansive significance to the term "forced labour" used in Art. 23(1) in a series of cases beginning with

the Asiad case in 1982 **People's Union for Democratic Rights v. Union of India, SC:**

the Court has insisted that Article 23 is intended to abolish every form of forced labour even if it has origin in a contract. Article 23 strikes at forced labour in whatever form it may manifest itself, because it is violative of human dignity and is contrary to the basic human values.

**In Sanjit Roy v. State of Rajasthan, 1983 case,** it was held that when a person provides labour or service to another for remuneration which is less than the prescribed minimum wages, the labour so provided clearly falls within the ambit of the words 'forced labour' under Article 23. The rationale adopted was that when someone works for less than the minimum wages, the presumption is that he or she is working under some compulsion. Hence it was held that such a person would be entitled to approach the higher judiciary under writ jurisdiction for the enforcement of fundamental rights which include the payment of minimum wages.

Article 24 of the Constitution of India states that "no child below the age of 14 years shall be employed to work in any factory or mine or engaged in any other hazardous employment". Article 24 is also enforceable against private citizens and lays down a prohibition against the employment of children below the age of 14 years in any factory or mine or any other hazardous employment.

This is also in consonance with Articles 39(e) and (f) in Part IV of the Constitution which emphasizes the need to protect the health and strength of workers, and also to protect children against exploitation. The Child Labour (Prohibition and Regulation) Act, 1986 specifically prohibits the employment of children in certain industries deemed to be hazardous and provides the scope for extending such prohibition to other sectors.

**In Peoples Union for Democratic Rights v. Union of India** (1982 SC) also known as the Asiad Workers case the Supreme Court observed that though the Employment of Children Act, 1938 did not include the construction work because the construction industry was not a process specified in the Schedule to the Act, yet, such construction was a hazardous occupation and under Article .24 children under 14 could not be employed in a hazardous occupation. The right of a child against exploitation under Article 24 is enforceable even in the absence of implementing legislation.

**In M.C. Mehta v. State of T.N.(1997 SC)** the Supreme Court directed that the employers of children below 14 years must comply with the provisions of the Child Labour (Prohibition and Regulation) Act providing for compensation, employment of their parents / guardians and their education.

Article 39(f) of the Constitution of India enumerates the importance of protecting children from exploitation and to give them proper opportunities and facilities to develop. These ideas are in consonance with the prohibitions against 'forced labour' and employment of children below the age of 14 years, which have been laid down under Article 23 and 24 respectively.

# LABOUR LAWS AND REFERENCE TO DIRECTIVE PRINCIPLES OF STATE POLICY

Today we are living in an era of welfare state which seeks to promote the prosperity and well-being of the people. The Directive Principles strengthen and promote this concept by seeking to lay down some socio-economic goals which the various governments in India have to strive to achieve. The Directive Principles are designed to usher in a social and economic democracy in the country. These principles obligate the state to take positive action in certain directions in order to promote the welfare of the people and achieve economic democracy. These principles give directions to the legislatures and the executive in India as regards the manner in which they should exercise their power.

The Courts however do not enforce a directive principle enshrined in Part IV of the Constitution unlike rights enshrined in Part III. The reason behind the legal non-enforceability and non-justiciability of these principles is that they impose positive obligations on the state. While taking positive action, government functions under several restraints, the most crucial of these being that of financial resources.

Nevertheless, the Constitution declares that the Directive Principles, though not enforceable by any Court, are 'fundamental' in the governance of the country, and the 'state' has been placed under an obligation to apply them in making laws. The state has thus to make laws and use its administrative machinery for the achievement of these Directive Principles.

Further, as reflected in its various recent judgements, the court is now more inclined in the integrative approach towards Fundamental Rights and Directive Principles; or that the both should be interpreted and read together. It has now become a judicial strategy to read Fundamental Rights along with Directive Principles with a view as the latter defines the scope and ambit of former. Mostly, Directive Principles have been used to broaden, and to give depth to some Fundamental Rights and to imply some more rights therefrom for the people over and above what are expressly stated in the Fundamental Rights.

## Equal Pay for Equal Work

Article 39 requires the state to direct its policy towards securing:

**a)** that all citizens, irrespective of sex, equally have the right to an adequate means of livelihood;

**b)** that the ownership and control of the material resources of the community are so distributed as best to subserve the common good;

**c)** that the operation of the economic system does not result in the concentration of wealth and means of production to the common detriment;

**d)** that there is equal work for both men and women;

**e)** that the health and strength of workers, men and women, and tender age of children are not abused and that citizens are not forced by economic necessity to enter avocations unsuited to their age or strength;

**f)** that children are given opportunities and facilities to develop in a healthy manner and in conditions of freedom and dignity and that childhood and youth are protected against exploitation and against moral and material abandonment.

In the case of Randhir Singh v. Union of India (1982) the Supreme Court has held that the principle of "Equal pay for equal work though not a fundamental right" is certainly a constitutional goal.

Article 39 (d) of the Constitution proclaims "equal pay for equal work for both men and women" as a Directive Principle of State Policy. The doctrine of equal pay for equal work is equally applicable to persons employed on a daily wage basis. They are also entitled to the same wages as other permanent employees in the department employed to do the identical work. However, the doctrine of 'equal pay for equal work' cannot be put in a strait jacket. Accordingly, it has been held that different scales of pay in the same cadre of persons doing similar work can be fixed if there is difference in the nature of work done and as regards reliability and responsibility.

**In the case of Dhirendra Chamoli and Anr. v. State of U.P. (AIR 1982 SC), the Court stated:**

"The fact that these employees accepted employment with full knowledge that they will be paid only daily wages and they will not get the same salary and conditions of service as other Class IV employees, cannot provide an escape to the Central Government to avoid the mandate of equality enshrined in Article 14 of the Constitution. This Article declares that there shall be equality before law and equal protection of the law and implicit in it is the further principle that there must be equal pay for work of equal value. These employees who are in the service of the different Nehru Yuvak Kendras in the country and who are admittedly performing the same duties as Class IV employees, must therefore get the same salary and conditions of service as Class IV employees. It makes no difference whether they are appointed in sanctioned posts or not. So long as they are performing the same duties, they must receive the same salary and conditions of service as Class IV employees."

**Bandhua Mukti Morcha and Ors. vs. Union of India (UOI) and Ors. (21.02.1997 - SC)**

In this case, petitioner's main contention was that employment of the children in any industry or in a hazardous industry, is violative of Article 24, Articles 39(e) and 45 of the Constitution read with the Preamble. Court stated that -

"Court has considered the constitutional perspectives of the abolition of the child labour and the child below 14 years of age in industries. We are of the view that a direction needs to be given that the Government to evolve the principles of policies for progressive elimination of employment of the children below the age of 14 years in all employments governed by the respective enactments mentioned in M.C. Mehta's case; to evolve such steps consistent with the scheme laid down in M.C. Mehta's case, to provide

1. compulsory education to all children either by the industries itself or in co-ordination with it by the State Government to the children employed in the factories, mine or any other industry, organised or unorganised labour with such timings as is convenient to impart compulsory education, facilities for secondary, vocational profession and higher education;
2. apart from education, periodical health check-up;
3. nutrient food etc.;

4. entrust the responsibilities for implementation of the principles. Periodical reports of the progress made in that behalf be submitted to the Registry of this Court."

## SOCIAL SECURITY PROVISIONS

Article 41 requires the state, within the limits of its economic capacity and development, to make effective provision for securing the right to work, to education and to public assistance in cases of unemployment, old age, sickness and disablement, and in other cases of undeserved want.

Social security is guaranteed in our Constitution under Articles 39, 41 and 43.

- The Employees' State Insurance Act, 1948 is a pioneering piece of legislation in the field of social insurance. The Employees' State Insurance Scheme provides for benefits in cash except the medical benefit, which is in kind.
- The Employees' Provident Funds and Miscellaneous Provisions Act, 1952 and the Maternity Benefit Act, 1961 are also social security measures to help fulfill the objectives of directive principles of our Constitution. The Provident Fund Scheme aimed at providing substantial security and timely monetary assistance to industrial employees and their families.
- The Maternity Benefit Scheme is primarily designed to provide maternity leave with full wages and security of employment.
- The object of the Payment of Gratuity Act, 1972 is to provide a scheme for the payment of gratuity to employees employed in factories, mines, oil fields, plantations, ports, railways, shops and establishments.
- Besides social security benefits, efforts have also been made to provide ample opportunities for employment and for workers' education. The Apprentices Act, 1961 was enacted to supplement the programme of institutional training by on-the-job training and to regulate the training arrangements in industry.

## WORKING CONDITIONS

Article 42 requires the state to make provision for securing just and humane conditions of work and for maternity relief.

## LIVING WAGE

Article 43 imposes an obligation towards ensuring the provision of a 'living wage' in all sectors as well as acceptable conditions of work. This provision enunciates the revolutionary doctrine that employees are entitled as of right to certain reliefs.

A 'living wage' is such wage as enables the male earner to provide for himself and his family not merely the bare essentials of food, clothing and shelter, but includes education for children, protection against ill-health, requirements of essential social needs, and a measure of insurance against the more important misfortunes including old age.

A 'minimum wage', on the other hand, is just sufficient to cover the bare physical needs of a worker and his family. Minimum wage is to be fixed in an industry irrespective of its capacity to pay. Fixation of minimum wage is in public interest and does not impose an unreasonable restriction on the right to carry on a trade guaranteed by Article 19(1)(g). (Edward Mills Co. v. Ajmer, AIR 1955 SC).

# Chapter 14 : Evaluation of Labour Legislation and Need of Labour Code

## REGULATORY FRAMEWORK

- Code on Wages 2019
- Code on Social Security, 2020
- Occupational Safety, Health and Working Conditions Code, 2020
- Industrial Relations Code, 2020

## INTRODUCTION

The law relating to labour and employment in India is primarily known under the broad category of "Industrial Law". Industrialization is considered to be one of the key engines to support the economic growth of any country. A plethora of labour laws have been established to ensure elevated health, safety, and welfare of workers; to protect workers against oppressive terms as individual worker is economically weak and has little bargaining power; to encourage and facilitate the workers in the organization; to deal with industrial disputes; to enforce social insurance and labour welfare schemes and alike.

Reforms in labour laws are an ongoing process to update the legislative system to address the need of the hour so as to make them more effective, flexible and in sync with emerging economic and industrial scenario. The Second National Commission on Labour has recommended that the existing Labour Laws should be broadly grouped into four or five Labour Codes on functional basis. Accordingly, the Government has taken steps for drafting four Labour Codes on Wages, Industrial Relations, Social Security & Welfare and Occupation Safety, Health and Working Conditions respectively, by simplifying, amalgamating and rationalizing the relevant provisions of the existing Central Labour Laws.

## NEED TO BRING IN NEW LEGISLATIONS

Labour is covered under the Concurrent List of the Constitution. Therefore, rules governing labour can be passed by both the Parliament and state legislatures. The resolution of labour disputes, working conditions, social security, and pay are only a few of the labor-related issues that are governed by more than 100 state and 40 federal laws, according to the central government. Labour Reforms also remained untouched during the economic reforms carried out in 1991.

The Second National Commission of Labour had submitted its report in 2002 which said that there was multiplicity of Labour Laws in India and therefore, recommended that at the Central level multiple Labour Laws should be codified in 4 or 5 Labour Codes namely (a) Industrial relations; (b) Wages; (c) Social security; (d) Safety; and (e) Welfare and working conditions. While discussions were held on it, however, no serious initiative was taken in this direction during the time period from 2004 to 2014.

The brainstorming on Labour Codes were fast-tracked when the GST, as One Nation One Tax, was made applicable in the Country with consensus and aligned with motto "Sabka Sath Sabka Vikas aur Sabka Vishwas".

By taking forward this progressive thinking, the reforms in Labour Laws were also speeded up. Extensive discussions were held before initiation of Labour Reforms by Ministry of Labour and Employment. Initially, as a part of Government's pre-legislative consultative policy, the

Ministry uploaded all the draft Labour Codes on its website for stakeholders and public consultation. During 2015 to 2019, the Ministry organized 9 tripartite discussions in which all the Central Trade Unions, Employers' Associations and representatives of State Governments were invited to give their opinions/suggestions on Labour reforms. All the four Bills were also examined by the Parliamentary Standing Committee which gave its recommendations to theGovernment.

In order to codify 29 central legislations, the Ministry of Labour and Employment submitted four labour code bills in 2019. While the Code on Wages, 2019, was approved by Parliament, the Standing Committee on Labour was tasked with handling the three other bills. On all three Bills, the Standing Committee delivered its reports. In September 2020, the government repealed these Bills and enacted new ones. They broadly categorized labour codes into 4 different category

1) Code on Wages
2) Industrial Relations Code
3) Social Security Code
4) Occupational Safety, Health and Working Conditions Code

## PURPOSE OF LABOUR LEGISLATION

Labour legislation that is adapted to the economic and social challenges of the modern world of work fulfils three crucial roles:

- it establishes a legal system that facilitates productive individual and collective employment relationships, and therefore a productive economy;
- by providing a framework within which employers, workers and their representatives can interact with regard to work-related issues, it serves as an important vehicle for achieving harmonious industrial relations based on workplace democracy;
- it provides a clear and constant reminder and guarantee of fundamental principles and rights at work which have received broad social acceptance and establishes the processes through which these principles and rights can be implemented and enforced.

## CLASSIFICATION OF LABOUR LAWS IN INDIA

Labour Laws may be classified under the following heads:

**I.** Laws related to Industrial Relations such as:
- Trade Unions Act, 1926
- Industrial Employment Standing Order Act, 1946
- Industrial Disputes Act, 1947

**II.** Laws related to Wages such as:
- Payment of Wages Act, 1936
- Minimum Wages Act, 1948
- Payment of Bonus Act, 1965
- Working Journalists (Fixation of Rates of Wages) Act, 1958

**III.** Laws related to Working Hours, Conditions of Service and Employment such as:
- Factories Act, 1948
- Plantation Labour Act, 1951
- Mines Act, 1952

- Working Journalists and other Newspaper Employees' (Conditions of Service and Misc. Provisions)Act, 1955
- Merchant Shipping Act, 1958
- Motor Transport Workers Act, 1961
- Beedi & Cigar Workers (Conditions of Employment) Act, 1966
- Contract Labour (Regulation & Abolition) Act, 1970
- Sales Promotion Employees Act, 1976
- Inter-State Migrant Workmen (Regulation of Employment and Conditions of Service) Act, 1979
- Dock Workers (Safety, Health & Welfare) Act, 1986
- Building & Other Construction Workers (Regulation of Employment & Conditions of Service) Act,1996
- Building and Other Construction Workers Welfare Cess Act, 1996
- Cine-Workers and Cinema Theatre Workers (Regulation of Employment) Act, 1981
- Dangerous Machines (Regulation) Act, 1983
- Dock Workers (Regulation of Employment) Act, 1948
- Dock Workers (Regulation of Employment) (Inapplicability to Major Ports) Act, 1997
- Employment of Manual Scavengers and Construction of Dry Latrines (Prohibition) Act, 1993
- Industrial Employment (Standing Orders) Act, 1946
- Mines and Mineral (Development and Regulation) Act, 1957
- Plantation Labour Act, 1951
- Private Security Agencies (Regulation) Act, 2005

**IV.** Laws related to Equality and Empowerment of Women such as:

- Maternity Benefit Act, 1961
- Equal Remuneration Act, 1976

**V.** Laws related to Deprived and Disadvantaged Sections of the Society such as:

- Bonded Labour System (Abolition) Act, 1976
- Child and Adolescent Labour (Prohibition & Regulation) Act, 1986
- Children (Pledging of Labour) Act, 1933.

**VI.** Laws related to Social Security such as:

- Employees' Compensation Act, 1923
- Employees' State Insurance Act, 1948
- Employees' Provident Fund & Miscellaneous Provisions Act, 1952.
- Payment of Gratuity Act, 1972
- Employers' Liability Act, 1938
- Beedi Workers Welfare Cess Act, 1976
- Beedi Workers Welfare Fund Act, 1976
- Cine workers Welfare Cess Act, 1981
- Cine Workers Welfare Fund Act, 1981
- Fatal Accidents Act, 1855
- Iron Ore Mines, Manganese Ore Mines and Chrome Ore Mines Labour Welfare Cess Act, 1976

- Iron Ore Mines, Manganese Ore Mines and Chrome Ore Mines Labour Welfare Fund Act, 1976
- Limestone and Dolomite Mines Labour Welfare Fund Act, 1972
- Mica Mines Labour Welfare Fund Act, 1946
- Personal Injuries (Compensation Insurance) Act, 1963
- Personal Injuries (Emergency Provisions) Act, 1962
- Unorganised Workers' Social Security Act, 2008.

## OBJECTIVE OF NEW LABOUR CODES

For the sake of clarity, standardisation in terminology, and consistency in approach, the Commission emphasised the necessity to streamline and unify labour legislation. Consolidating labour laws would also enable more comprehensive labour coverage because separate labour rules apply to different employment classifications and across different thresholds. The four Codes on wages, industrial relations, social security, and occupational safety were introduced in Parliament as a result of NCL's recommendations.

While the Codes do a good job of combining and streamlining existing legislation, there are several areas where they fall short. For instance, the Codes on Social Security and Occupational Safety continue to include specific provisions from each of the statutes that these Codes replace. For instance, even if the Occupational Safety Code includes provisions on leaves for all employees, sales promotion staff continue to be entitled to additional leave entitlements (such as earned medical leave for 1/18th of the period on duty). Similar to this, even if the definitions of various terms are largely rationalised by the Codes, they are not consistent throughout. For instance, the definition of "contractor" is the same in the Codes on Wages, Occupational Safety, and Social Security but not in the Code on Industrial Relations. Finally, after much discussions only 29 laws have been replaced by the four Codes.

Facilitating employment development while preserving employees' rights is the main problem of labour reforms. The coverage of small businesses, choosing cut off points for prior approval of layoffs, bolstering labour enforcement, enabling flexible forms of labour, and supporting collective bargaining are important topics of discussion. In addition, as time goes on, it is necessary to update and simplify the labour laws in order to include clauses that can accommodate new kinds of employment (e.g., gig work).

## FEATURES OF NEW LABOUR CODES

1) Most labour rules are applicable to businesses larger than a particular size (typically 10 or above). Thresholds based on company size could ease the burden of compliance for businesses. One would counter that all businesses should be subject to fundamental protections including pay, social security, and working conditions. Such size-based limits are still present in some codes.
2) Simple and accountable system will simplify the processes. One Registration one License, single return for all the Codes.
3) Government approval is required for establishments that employ 100 or more employees to close, lay off, or retrench. It has been suggested that this has made it harder for businesses to leave and has interfered with their capacity to change their staff to meet production demands. This number is increased to 300 by the Industrial Relations Code, and the government is permitted to raise it further by notification.
4) The complexity of labour laws has led to many compliances, which has increased the burden of compliance on businesses. On the other side, the labour enforcement

apparatus has been unsuccessful due to weak enforcement, insufficient sanctions, and inspectors' rent-seeking behaviour. Some of these issues are covered by the Codes.

5) Contract labour is now used more frequently as a result of economic factors and labour compliance requirements. However, fundamental rights like guaranteed salaries have been denied to contract workers. These issues are not entirely addressed by the Codes. Fixed-term employment, however, is a new type of short-term labour that is introduced by the Industrial Relations Code.
6) There are many registered trade unions, but there are no standards by which to "recognise" unions that can formally bargain with employers. Provisions for recognition are created by the Industrial Relations Code.
7) The Codes greatly simplify labour rules, yet there are several areas where they fall short. Additionally, the Code on Social Security has enabling measures to notify programmes for "gig" and "platform" workers; nonetheless, these classifications lack precision.
8) The Codes delegate rule-making authority over a number of significant issues, including the applicability of social security programmes and health and safety regulations. The debate is on whether the legislature or the executive branch should decide these issues.
9) The law forbids discrimination based on gender when it comes to hiring new employees for similar or identical jobs and determining pay. Work of a similar kind is defined as work requiring the same level of expertise, effort, responsibility, and experience.
10) The advisory boards will be made up of the federal and state governments. Employers, employees (equal in number to employers), independent individuals, and five state government representatives make up the Central Advisory Board. State Advisory Boards will be made up of independent individuals, employers, and workers. Women will make up one-third of both the central and state boards' overall membership. The Boards will give their respective governments advice on matters such as:
    i. setting minimum wages and
    ii. expanding possibilities for women in the workforce.
11) The Code outlines punishments for offences committed by an employer, such as (i) underpaying required wages or (ii) violating any Code requirement. The maximum punishment is three months in prison and a fine of up to one lakh rupees. Penalties varies based on the type of offence.

## ACTS SUBSUMED BY THE FOUR LABOUR CODES

| Labour Codes | Acts being subsumed |
|---|---|
| Code on Wages, 2019 | ➢ Payment of Wages Act, 1936;<br>➢ Minimum Wages Act, 1948;<br>➢ Payment of Bonus Act, 1965; and<br>➢ Equal Remuneration Act, 1976. |
| Occupational Safety, Health and Working Conditions Code, 2019 | ➢ Factories Act, 1948;<br>➢ Mines Act, 1952;<br>➢ Dock Workers (Safety, Health and Welfare) Act, 1986;<br>➢ Building and Other Construction Workers (Regulation of Employment and Conditions of Service) Act, 1996;<br>➢ Plantations Labour Act, 1951;<br>➢ Contract Labour (Regulation and Abolition) Act, 1970;<br>➢ Inter-State Migrant Workmen (Regulation of Employment and Conditions of Service) Act, 1979; |

| | |
|---|---|
| | ➢ Working Journalist and other Newspaper Employees (Conditions of Service and Miscellaneous Provision) Act, 1955;<br>➢ Working Journalist (Fixation of Rates of Wages) Act, 1958;<br>➢ Motor Transport Workers Act, 1961;<br>➢ Sales Promotion Employees (Condition of Service) Act, 1976;<br>➢ Beedi and Cigar Workers (Conditions of Employment) Act, 1966;<br>➢ Cine-Workers and Cinema Theatre Workers (Regulation of Employment) Act,1981. |
| Industrial Relations Code, 2019 | ➢ Trade Unions Act, 1926;<br>➢ Industrial Employment (Standing Orders) Act, 1946, and<br>➢ Industrial Disputes Act, 1947. |
| Code on Social Security, 2019 | ➢ Employees' Provident Funds and Miscellaneous Provisions Act, 1952;<br>➢ Employees' State Insurance Act, 1948;<br>➢ Employees' Compensation Act, 1923;<br>➢ Employment Exchanges (Compulsory Notification of Vacancies) Act, 1959;<br>➢ Maternity Benefit Act, 1961;<br>➢ Payment of Gratuity Act, 1972;<br>➢ Cine-workers Welfare Fund Act, 1981;<br>➢ Building and Other Construction Workers' Welfare Cess Act, 1996; and<br>➢ Unorganised Workers Social Security Act, 2008 |

## Reforms Proposed by New Labour Codes

**Code on Social Security, 2020**

A Code to amend and consolidate the laws relating to social security with the goal to extend social security to all employees and workers either in the organised or unorganised or any other sectors or for matters connected therewith or incidental thereto. To ensure security for all workers, the Central Government has amalgamated 9 Labour Laws into the Social Security Code in order to secure the right of workers for insurance, pension, gratuity, maternity benefit etc. The Government can fund the contribution of workers from disadvantaged section.

The salient features of the Code on Social Security, 2020, inter alia, are–

- ❖ Benefit of pension scheme (EPFO) to all workers of organized, unorganized and self-employed sectors.
- ❖ Creation of social security fund for providing comprehensive social security to the unorganized sector.
- ❖ Through a small contribution, benefit of free treatment is available under hospitals and dispensaries of
- ❖ ESIC.
- ❖ The doors of ESIC will now be opened for the workers of all sectors along with the workers of the unorganized sector.

- Expansion of ESIC hospitals, dispensaries and branches upto district level.
- To define various expressions used in the Code such as, "career centre","aggregator", "gig worker", "platform worker", "wage ceiling" , etc. Further, the definition of "employee" has been comprehensively elaborated to cover maximum number of employees and workers.
- Even if a single worker is engaged in hazardous work, he would be given ESIC benefit.
- Opportunity to join ESIC for platform and gig workers engaged in new technology.
- Plantation workers to get benefit of ESIC.
- Institutions working in hazardous area to be compulsorily registered with ESIC.
- Constitution of various social security organisations for the administration of the Code, namely, (a) the
- Central Board of Trustees of the Employees' Provident Fund (Central Board), (b) the Employees' State
- Insurance Corporation (Corporation), (c) the National Social Security Board for Unorganised Workers (National Social Security Board), (d) the State Unorganised Workers' Social Security Board and (e) the State Building Workers Welfare Boards.
- Provisions for maternity benefits such as prohibition from work during certain periods, provision of nursing breaks, crèche facility, claim for maternity benefits, etc.
- To provide for appeal against an order passed by any authority in regard to determination and assessment of dues and levy of damages relating to Employees' Provident Fund by an employer only after depositing with Social Security Organisation concerned, twenty-five per cent. of the amount due from him as determined by the authority against whose order the appeal has been preferred.
- Requirement of minimum service has been removed for payment of gratuity in case of fixed term employees.
- Employees engaged on fixed term to get same social security benefit as permanent employees.
- Creating a national database of workers of unorganized sector through registration on Portal.
- Employers employing more than 20 workers to mandatorily report vacancies online.
- A Universal Account Number (UAN) for ESIC, EPFO and Unorganised Sector Workers. Along with Aadhaar based Universal Account Number (UAN) to ensure seamless portability.
- To empower the Central Government by order, to defer or reduce employer's contribution, or employee's contribution, or both.
- To provide for establishment and maintenance of separate accounts under social security fund, for the welfare of unorganised workers, gig workers and platform workers; and a separate account for the amount received from the composition of offences under the Code or under any other central labour laws.

## OCCUPATIONAL SAFETY, HEALTH AND WORKING CONDITIONS CODE, 2020

A Code to consolidate and amend the laws regulating the occupational safety, health and working conditions of the persons employed in an establishment and for matters connected therewith or incidental thereto. The security of interests of workers engaged in factories, mines, plantations, motor transport sector, bidi and cigar workers, contract and migrant workers has been ensured.

The salient features of the Occupational Safety, Health and Working Conditions Code, 2020 inter alia, are as under:—

- To impart flexibility in adapting technological changes and dynamic factors, in the matters relating to health, safety, welfare and working conditions of workers.
- To apply the provisions of the Code for all establishments having ten or more workers, other than the establishments relating to mines and docks; more employees.
- Various provisions in the OSHWC Code will ease the lives of the Inter-State Migrant Workers.
- Anomalies of the Inter-State Migrant Workers Act, 1979 have been comprehensively addressed in the OSHWC Code. Earlier only workers appointed by a contractor were recognized as Inter-State Migrant Workers. By this provision, the worker would get a legal identity which would enable them to get benefits of all social security schemes.
- A provision has been made for employers to provide travelling allowance annually to an Inter-State Migrant Worker for undertaking a to-and-fro journey to his native place.
- Providing of appointment letters to the workers has been made mandatory.
- Mandatory, free annual health check-up of the workers to be provided by the employers.
- For a worker engaged in building and other construction work in one State and moving to another State, benefit from the Building and other Construction Workers' Cess fund will be provided.
- Under the "One Nation - One Ration Card", an Inter-State Migrant Worker would get ration facility in the State he is working in and the remaining members of his family would be able to avail of the ration facility in the State where they reside.
- Mandatory helpline facility in every State for resolution of Inter-State Migrant Workers 'grievances.
- National database to be created for the Inter State Migrant Workers.
- Instead of 240 days, now if a worker has worked 180 days, he shall be entitled for one-day leave for every 20 days of work done.
- Emphasis on women empowerment through the Labour Codes.
- Right to women workers to work in all types of establishments.
- Women have been given the right to work at night with their consent and it has also been ensured that the employer would make adequate arrangements to provide safety and facilities to women workers at night.
- Maternity Benefit Act paid Maternity leave for women workers to 26 weeks and ensure mandatory crèche facility in all establishments having 50 or more workers.
- To provide for issuing of appointment letter mandatorily by the employer of an establishment to promote formalisation in employment.
- To constitute the National Occupational Safety and Health Advisory Board to give recommendations to the Central Government on policy matters, relating to occupational safety, health and working conditions of workers.
- To constitute the State Occupational Safety and Health Advisory Board at the State level to advice the State Government on such matters arising out of the administration of the Code.
- To make a provision for the constitution of Safety Committee by the appropriate Government in any establishment or class of establishments.
- To make provision of "common license" for factory, contract labour and beedi and cigar establishments and to introduce the concept of a single all India license for a period of five years to engage the contract labour.

- To enable the courts to give a portion of monetary penalties up to fifty per cent. to the worker who is a victim of accident or to the legal heirs of such victim in the case of his death.
- To provide overriding powers to the Central Government to regulate general safety and health of persons residing in whole or part of India in the event of declaration of epidemic or pandemic or disaster.

## Code on Wages, 2019

A Code to amend and consolidate the laws relating to wages and bonus and matters connected therewith or incidental thereto. Four Labour Laws have been amalgamated into the Minimum Wages Code. Due to this, for the first time, all the workers have got the Right to Minimum Wages.

The salient features of the Code on Wages, 2019, inter alia, are as follows:—

- To provide for all essential elements relating to wages, equal remuneration, its payment and bonus.
- To provide wage security, social security and health security to workers, covering organized and unorganized sectors.
- The guarantee of minimum wages is available to workers of organized and unorganized sectors.
- Review of minimum wages in every 5 years.
- Guarantee of timely payment of wages to all workers.
- Equal remuneration to male and female workers.
- For the first time workers of unorganized sector in the country have got this right.
- To remove regional disparity in minimum wages the provision of floor wage has been introduced.
- The determination of minimum wages has been made easy. It will be based on criteria such as skill level and geographical area.
- The appropriate Government may extend the coverage of wage ceiling to the Government establishments also.
- The minimum wage decided by the government should be higher than the floor wage.
- It provides that the wages to employees may also be paid by cheque or through digital or electronic mode or by crediting it in the bank account of the employee. However, the appropriate Government may specify the industrial or other establishment, where the wages are to be paid only by cheque or
- through digital or electronic mode or by crediting the wages in the bank account of the employee.
- In order to remove the arbitrariness and malpractices in inspection, it empowers the appropriate Government to appoint Inspectors-cum-Facilitators in the place of Inspectors, who would supply information and advice the employers and workers.
- It enables the appropriate Government to establish an appellate authority to hear appeals for speedy, cheaper and efficient redressal of grievances and settlement of claims.
- It provides for graded penalty for different types of contraventions of the provisions of the legislation.

- It provides that the Inspector-cum-Facilitator shall give an opportunity to the employer before initiation of prosecution proceedings in cases of contravention, so as to comply with the provisions of the legislation.
- However, in case of repetition of the contravention within a period of five years such opportunity shall not be provided.
- It provides for compounding of those offences which are not punishable with imprisonment.
- The period of limitation for filing of claims by a worker has been enhanced to three years, as against the existing time period varying from six months to two years, to provide a worker more time to settle his claims.
- It provides that where a claim has been filed for non-payment of remuneration or bonus or less payment of wages or bonus or on account of making deduction not authorised by the legislation, the burden shall be on the employer to prove that the said dues have been paid to the employee.
- It enables the appropriate Government to constitute Advisory Boards at Central and State level to advice the Central Government and the State Governments, respectively, on matters relating to wages, women employment, etc.

## Industrial Relations Code, 2020

A code to consolidate and amend the laws relating to Trade Unions, conditions of employment in industrial establishment or undertaking, investigation and settlement of industrial disputes and for matters connected therewith or incidental thereto. By amalgamating 3 Labour Laws into the Industrial Relations Code the Central Government has taken steps for safeguarding the interests of Trade Unions as well as the workers. In this Code, all possible steps have been taken for industrial units and workers so that disputes do not arise in future.

The salient features of the Industrial Relations Code, 2020, inter alia, are as follows:-

- To define "workers" which includes the persons in supervisory capacity getting wages up to eighteen thousand rupees per month or an amount as may be notified by the Central Government from time to time.
- To provide for fixed term employment with the objective that the employee gets all the benefits like that of a permanent worker (including gratuity), except for notice period after conclusion of a fixed period, and retrenchment compensation. The employer has been provided with the flexibility to employ workers on fixed term basis on the basis of requirement and without restriction on any sector.
- To revise the definition of "industry" that any systematic activity carried on by co-operation between the employer and workers for the production, supply or distribution of goods or services with a view to satisfy human wants or wishes (not being wants or wishes which are merely spiritual or religious in nature) with certain exceptions.
- To bring concerted casual leave within the ambit of the definition of strike.
- To provide the maximum number of members in the Grievance Redressal Committee up to ten in an industrial establishment employing twenty or more workers. There shall be adequate representation of the women workers therein in the proportion of the women workers to the total workers employed in the industrial establishment.

- Under the Atal Bimit Vyakti Kalyan Yojna, a worker of organized sector who loses his job gets financial aid from the Government. This is a type of unemployment allowance, the benefit of which is admissible to the workers covered under the ESI Scheme.
- In case of job loss, a worker will get benefit under the Atal Bimit Vyakti Kalyan Yojna.
- At the time of retrenchment a worker would be provided 15 days' wages for re-skilling. The wages would be credited directly into the bank account of the worker so as to enable him to learn new skills.
- To provide for appeal against non-registration or cancellation of registration of Trade Union before the Industrial Tribunal.
- To empower the Central Government and the State Governments to recognise a Trade Union or a federation of Trade Unions as the Central Trade Union or State Trade Unions, respectively.
- To provide for applicability of threshold of three hundred or more workers for an industrial establishment to obtain certification of standing orders, if the standing order differ from the model standing order made by the Central Government.
- Faster justice to the workers through the Tribunal.
- Workers disputes to be resolved within a year in the Tribunal.
- To set up Industrial Tribunal consisting of a Judicial Member and an Administrative Member, in place of only Judicial Member who presently presides the Tribunal. For certain specified cases, the matters will
- be decided by the two-member Tribunal and the remaining shall be decided by single-member Tribunal
- as may be provided for in the rules.
- To set up Industrial Tribunals in the place of existing multiple adjudicating bodies like the Court of Inquiry, Board of Conciliation and Labour Courts.
- To remove the reference system for adjudication of Industrial Disputes, except the reference to the National Industrial Tribunal for adjudication.
- To prohibit strikes and lock-outs in all industrial establishments without giving notice of fourteen days
- To provide for a new feature of recognition of negotiating union and negotiating council in an industrial establishment by an employer for the purpose of negotiations. The criterion for recognition of negotiating union has been fixed at fifty-one per cent. or more workers on a muster roll of that industrial establishment. As regards negotiating council, a Trade Union having support of every twenty per cent. of workers will get one seat in the negotiating council and the fraction above twenty per cent. shall be disregarded.
- Trade unions have been conferred with a new right, enabling them to get statutory recognition.
- To provide for penalties for different types of violations to rationalise with such offences and commensurate with the gravity of the violations.
- To empower the appropriate Government to exempt any industrial establishment from any of the provisions of the Code in the public interest for the specified period.
- To provide for the obligation on the part of industrial establishments pertaining to mine, factories and plantation having three hundred or more workers to take prior permission of the appropriate Government before lay-off, retrenchment and closure with flexibility to the appropriate Government to increase the threshold to higher numbers, by notification.

- To provide for compounding of offences by a Gazetted Officer, as the appropriate Government may,by notification, specify, for a sum of fifty per cent of the maximum fine provided for such offence punishable with fine only and for a sum of seventy-five per cent. provided for such offence punishable with imprisonment for a term which is not more than one year, or with fine.

Labour Code will facilitate the implementation and also remove the multiplicity of definitions and authorities without compromising on the basic concepts of welfare and benefits to workers. The Code would bring the use of technology in its enforcement. All these measures would bring transparency and accountability which would lead to more effective enforcement. Widening the scope of minimum wages to all workers would be a big step for equity. The facilitation for ease of compliance of labour laws will promote in setting up of more enterprises thus catalyzing the creation of employment opportunities.

# Chapter 15 : Law of Welfare & Working Condition

# Unit I – Factories Act, 1948

## Regulatory Framework

**Factories Act, 1948**

Factories Act, 1948 is an act to consolidate and amend the law regulating labour in factories. The main objective of the Act is

- to ensure adequate safety measures
- to promote health and welfare of the workers employed in factories
- to prevent haphazard growth of factories.

This Act is legislated to lay guidelines on working conditions in factories including leaves, working hours, holidays, etc. It also ensures health, safety and welfare measures of workers in factories. This Act made mandatory medical examination for children under the age of 15 while admitting to work as well periodically.

## Object of the Act

In the case of **Ravi Shankar Sharma v. State of Rajasthan,** Court held that Factories Act is a social legislation and it provides for the health, safety, welfare and other aspects of the workers in the factories. In short, the Act is meant to provide protection to the workers from being exploited by the greedy business establishments and it also provides for the improvement of working conditions within the factory premises.

In **Bhikusa Yamasa Kshatriya (P.) Ltd. v. UOI,** the court observed that the Act has been enacted primarily with the object of protecting workers employed in factories against industrial and occupational hazards. For that purpose, it seeks to impose upon the owner or the occupier certain obligations to protect the workers and to secure for them employment in conditions conducive to their health and safety.

The landmark case of **J.K. Industries Limited, etc. v. The Chief Inspector of Factories,** stated that "A piece of social welfare legislation enacted primarily with the object of protecting workmen employed in factories against industrial and occupational hazards. It seeks not only to ensure that workers would not be subjected to long hours of strain but also that employees should work in safe, healthy and sanitary conditions and that adequate precautions are taken for their welfare and safety. The stringent provisions relating to the obligations of the occupiers or managers with a view to protect workers and to secure to them employment in conditions conducive to their health and safety indicate the board purpose of the Act."

## Applicability of the Act

- It extends to the whole of India.
- It applies to factories as defined under the Act.
  Applicable to all factories using power and employing 10 or more workers, and if not using power, employing 20 or more workers on any day of the preceding 12 months. But it does not include a mine subject to the operation of the Mines Act, 1952 or a mobile unit

belonging to the armed forces of the Union, a railway running shed or a hotel, restaurant or eating place.

- The benefits of this Act are available to persons who are employed in the factory and be covered within the meaning of the term "worker" as defined in the Act. But the definition of worker excludes any member of the armed forces of the Union.

## Definitions

| Term | Section | Definition |
|---|---|---|
| "Adolescent" | Section 2(b) | Adolescent means a person who has completed his fifteenth year of age but has not completed his eighteenth year; |
| "Child" | Section 2(c) | Child means a person who has not completed his fifteenth year of age; |
| "Hazardous Process" | Section 2(cb) | Hazardous process means any process or activity in relation to an industry specified in the 1st Schedule where, unless special care is taken, raw materials used therein or the intermediate or finished products, bye-products, wastes, or effluents thereof would-<br>i. cause material impairment to the health of the persons engaged in or connected therewith, or<br>ii. result in the pollution of the general environment: |
| "Power" | Section 2(g) | Power means electrical energy, or any other form of energy which is mechanically transmitted and is not generated by human agency; |

## "Manufacturing Process" {Section 2(k)}

Manufacturing Process means any process for —

1. making, altering, repairing, ornamenting, finishing, packing, oiling, washing, cleaning, breaking up, demolishing, or otherwise treating or adapting any article or substance with a view to its use, sale, transport, delivery or disposal; or
2. pumping oil, water, sewage or any other substance; or
3. generating, transforming or transmitting power; or
4. composing types for printing, printing by letter press, lithography, or other similar process or book binding; or
5. constructing, reconstructing, repairing, refitting, finishing or breaking up ships or vessels; or
6. preserving or storing any article in cold storage;

An important necessity for any premises to be regarded as a 'factory' is, that a "manufacturing process" should be conducted within the premises.

## "Factory" {Section 2(m)}

Factory means any premises including the precincts thereof-

1. whereon 10 or more workers are working, or were working on any day of the preceding 12 months, and in any part of which a manufacturing process is being carried on with the aid of power, or is ordinarily so carried on, or
2. Whereon 20 or more workers are working, or were working on any day of the preceding 12 months, and in any part of which a manufacturing process is being carried on without the aid of power, or is ordinarily so carried on.

The definition of factory specifically excludes from its purview a mine subject to the operation of the Mines Act, 1952 or a mobile unit belonging to the armed forces of the Union, a railway running shed or a hotel, restaurant or eating place.

## "Occupier" {Section 2(n)}

Occupier of a factory means the person who has ultimate control over the affairs of the factory;

Provided that —

1. in the case of a firm or other association of individuals, any one of the individual partners or members thereof shall be deemed to be the occupier;
2. in the case of a company, any one of the directors shall be deemed to be the occupier;
3. in the case of a factory owned or controlled by the Central Government or any State Government, or any local authority, the person or persons appointed to manage the affairs of the factory by the Central Government, the State Government or the local authority, as the case may be, shall be deemed to be the occupier.

It is provided further that in the case of a ship which is being repaired, or on which maintenance work is being carried out, in a dry dock which is available for hire,-

1) the owner of the dock shall be deemed to be the occupier for the purposes of any matter provided for by dry dock
2) the owner of the ship or his agent or master or other office-in-charge of the ship or any person who contracts with such owner, agent or master or other officer-in-charge to carry out the repair or maintenance work shall be deemed to be the occupier.

**Exemption of occupier or manager from liability in certain cases**

Section 101 provides exemptions from liability of occupier or manager. It permits an occupier or manager of a factory who is charged with an offence punishable under the Act to bring into the Court any other person whom he charges actual offender and also proves to the satisfaction of the Court that:

a. he has used due diligence to enforce the execution of this Act; and
b. that the offence in question was committed without his knowledge, consent or connivance, by the said other person.

The other person shall be convicted of the offence and shall be liable to the like punishment as if he were the occupier or manager of the factory. In such a case occupier or manager of the factory is discharged from liability. The Section is an exception to principles of strict liability, but benefit of this would be available only when the requirements of this section are

fully complied with and the court is fully satisfied about the proof of facts contemplated in (a) and (b) above.

## Statutory Agencies and their powers for enforcement of the Act

The State Governments assume the main responsibility for administration of the Act and its various provisions by utilising the powers vested in them.

1) **Reference to time of day (Section 3):** This section empowers the State Government to make rules for references to time of day where IST, being 5:30+ ahead of GMT is not ordinarily observed.

   These rules may specify the area, define the local mean time ordinarily observed therein, and permit such time to be observed in all or any of the factories situated in the area.

2) **Power to declare different departments to be separate factories or two or more factories to be a single factory (Section 4):** The State Government may on its own or on an application made in this behalf by an occupier, direct, by an order in writing and subject to such conditions as it may deem fit, that for all or any of the purposes of this act:
   - different departments or branches of a factory of the occupier specified in the application shall be treated as separate factories or
   - that two or more factories of the occupier specified in the application shall be treated as a single factory.

3) **Power to exempt during public emergency (Section 5):** In any case of public emergency the State Government may, by notification, exempt any factory or class or description of factories from all or any of the provisions of this Act for such period and subject to such conditions as it may think fit. It is provided that no such notification shall be made for a period exceeding 3 months at a time.

   **Explanation:** For the purposes of this section "public emergency" means a grave emergency whereby the security of India or of any part of the territory thereof is threatened, whether by war or external aggression or internal disturbance.

4) **Power of the State Government to make rules with reference to approval, licensing and registration of factories:**

   Section 6 (1) of the Act authorize the State Government to make rules-

   1) requiring, for the purposes of the Act, the submission of plans of any class or description of factories to the Chief Inspector or the State Government;
   2) requiring the previous permission in writing of the State Government or the Chief Inspector to be obtained for the site on which the factory is to be situated and for the construction or extension of any factory;
   3) requiring for the purpose of considering applications for such permission the submission of plans and specifications;
   4) prescribing the nature of such plans and specifications and by whom they shall be certified;
   5) requiring the registration and licensing of factories or any class or description of factories, and prescribing the fees payable for such registration and licensing and for the renewal of licenses;

## Agencies of the State Government to carry out administration of the Act:

### 1) Inspectors

**Appointment:** Section 8 empowers the State Government to appoint Inspectors, Additional Inspectors and Chief Inspectors, such persons who possess prescribed qualifications.

Section 8(2) empowers the State Government to appoint any person to be a Chief Inspector. To assist him, the government may appoint Additional, Joint or Deputy Chief Inspectors and such other officers as it thinks fit.

**Every District Magistrate shall be an Inspector for his district.** The State Government may appoint certain public officers, to be the Additional Inspectors for certain areas assigned to them. The appointment of Inspectors, Additional Inspectors and Chief Inspector can be made only by issuing a notification in the Official Gazette.

**Powers of Inspectors (Section 9)**

An Inspector may, within the local limits for which he is appointed, exercise the following powers-

a. enter,
   - with such assistants, being persons in the service of the government, or
   - any local or other public authority, or
   - with an expert as he thinks fit,

   any place which is used, or which he has reason to believe is used, as a factory;
b. make examination of the premises, plant, machinery, article or substance;
c. inquire into any accident or dangerous occurrence, whether resulting in bodily injury, disability or not, and take on the spot or otherwise statements of any person which he may consider necessary for such inquiry;
d. require the production of any prescribed register or any other document relating to the factory;
e. seize, or take copies of, any register, record or other document or any portion thereof as he may consider necessary in respect of any offence under this Act, which he has reason to believe, has been committed;
f. direct the occupier that any premises or any part thereof, or anything lying therein, shall be left undisturbed (whether generally or in particular respects) for so long as is necessary for the purpose of any examination under clause (b);
g. take measurements and photographs and make such recordings as he considers necessary for the purpose of any examination under clause (b), taking with him any necessary instrument or equipment;
h. in case of any article or substance found in any premises, being an article or substance which appears to him as having caused or is likely to cause danger to the health or safety of the workers, direct it to be dismantled or subject it to any process or test, and take possession of any such article or substance or a part thereof, and detain it for so long as is necessary for such examination;
i. exercise such other powers as may be prescribed:

### 2) Certifying surgeons

According to section 10, the State Government may appoint qualified medical practitioners to be certifying surgeons for the purposes of this Act within such local limits or for such factory or class or description of factories as it may assign to them respectively.

A certifying surgeon may, with the approval of the State Government, authorize any qualified medical practitioner to exercise any of his powers under this Act for such period as the certifying surgeon may specify and subject to such conditions as the State Government may think fit to impose.

No person shall be appointed to be, or authorized to exercise the powers of a certifying surgeon, who is or becomes the occupier of a factory or is or becomes directly or indirectly interested therein or in any process or business carried on therein or in any patent or machinery connected therewith or is otherwise in the employ of the factory.

The certifying surgeon shall carry out such duties as may be prescribed in connection with-

**a.** the examination and certification of young persons under this Act;

**b.** the examination of persons engaged in factories in such dangerous occupations or processes as may be prescribed;

**c.** the exercising of such medical supervision as may be prescribed where —

- cases of illness have occurred which it is reasonable to believe are due to the nature of the manufacturing process carried on, or other conditions of work prevailing, therein;
- by reason of any change in the manufacturing process carried on or in the substances used therein or by reason of the adoption of any new manufacturing process or of any new substance for use in a manufacturing process, there is a likelihood of injury to the health of workers employed in that manufacturing process;
- young persons are, or are about to be, employed in any work which is likely to cause injury to their health.

### 3) Welfare Officer

Section 49 of the Act imposes statutory obligation upon the occupier of the factory of the appointment of Welfare Officer wherein 500 or more workers are ordinarily employed.

### 4) Safety Officer

Section 40-B empowers the State Government for directing an occupier of factory to employ such number of Safety Officers as specified by it where more than 1,000 workers are employed or where manufacturing process involves risk of bodily injury, poisoning or disease or any other hazard to health of the persons employed therein.

## Duties of Occupier / Manufacturer

i. **Notice by occupier (Section 7):** Section 7(1) states that a written notice shall be sent by the occupier at least 15 days before he begins to occupy or use any premises as a factory, to the Chief Inspector.

The notice shall contain following details: -

a. The name and situation of the factory;
b. the name and address of the occupier;
bb. the name and address of the owner of the premises or building;
c. the address to which communications relating to the factory may be sent;
d. the nature of the manufacturing process-
    - carried on in the factory during the last 12 months in the case of factories in existence on the date of the commencement of this Act; and
    - to be carried on in the factory during the next 12 months in the case of all factories;
e. the total rated horse power installed or to be installed in the factory;
f. the name of the manager of the factory for the purposes of this Act;
g. the number of workers likely to be employed in the factory;
h. the average number of workers per day employed during the last 12 months in the case of a factory in existence on the date of the commencement of this Act;
i. such other particulars as may be prescribed.

Sub-section (2) states that in respect of all establishments which come within the scope of the Act for the first time, the occupier shall send a written notice to the Chief Inspector containing the particulars specified in sub- section (1) within 30 days from the date of the commencement of this Act.

In pursuance to sub-section (3), the occupier shall send a written notice to the Chief Inspector containing the particulars specified in sub-section (1) at least 30 days before the date of the commencement of work, in case of a factory engaged in a manufacturing process which is ordinarily carried on for less than 180 working days in the year resumes working.

**Notice of appointment of new manager:** Whenever a new manager is appointed, the occupier shall send to the Inspector a written notice and to the Chief Inspector a copy thereof within 7 days from the date on which such person takes over charge.

**Manager, Deemed Occupier:** During any period for which no person has been designated as manager of a factory or during which the person designated does not manage the factory, any person found acting as a manager, or if no such person is found, **the occupier himself, shall be deemed to be the manager of the factory for the purposes of this Act.**

ii. **General duties of the occupier (Section 7A)**

Sub-section (1) mandates that every occupier shall ensure, so far as is reasonably practicable, the health, safety and welfare of all workers while they are at work in the factory. Sub-section (2) provides the matters covered under this duty of the occupier:

a. the provision and maintenance of plant and systems of work in the factory that are safe and without risks to health;
b. the arrangements in the factory for ensuring safety and absence of risks to health in connection with the use, handling, storage and transport of articles and substances;

c. the provision of such information, instruction, training and supervision as are necessary to ensure the health and safety of all workers at work;
d. the maintenance of all places of work in the factory in a condition that is safe and without risks to health and the provision and maintenance of such means of access to such places as are safe and without such risks;
e. the provision, maintenance or monitoring of such working environment in the factory for the workers that is safe, without risks to health and adequate as regards facilities and arrangements for their welfare at work.

**iii. General duties of manufacturers, etc., as regards articles and substances for use in factories (Section 7B)**

Sub-section (1) casts an obligation on every person who designs, manufactures, imports or supplies any article for use in any factory that he shall –

a. ensure, so far as is reasonably practicable, that the article is so designed and constructed as to be safe and without risks to the health of the workers when properly used;
b. carry out or arrange for the carrying out of such tests and examination as may be considered necessary for the effective implementation of the provisions of clause (a);
c. take such steps as may be necessary to ensure that adequate information will be available
   i. in connection with the use of the article in any factory;
   ii. about the use for which it is designed and tested; and
   iii. about any conditions necessary to ensure that the, when put to such use, will be safe, and without risks to the health of the workers:

It is provided that where an article is designed or manufactured outside India, it shall be obligatory on the part of the importer to see –

a. that the article conforms to the same standards if such article is manufactured in India, or
b. if the standards adopted in the country outside for the manufacture of such article is above the standards adopted in India, that the article conforms to such standards.

Every person, who undertakes to design or manufacture any article for use in any factory may carry out or arrange for the carrying out of necessary research with a view to the discovery and, so far as is reasonably practicable, the elimination or minimization of any risks to the health or safety of the workers to which the design or article may give rise.

The above provisions shall be construed to require a person to repeat the testing, examination or research which has been carried out otherwise than by him or at his instance in so far as it is reasonable for him to rely on the results thereof for the purposes of the said sub-sections.

## Measures to be taken by factories for health, safety and welfare of workers

These measures are provided under Chapters III, IV and V of the Act which are as follows:

### Health

Chapter III of the Act deals with the following aspects:

i. **Cleanliness:** Section 11 of the Act makes provisions for ensuring cleanliness in the factory. It states that every factory shall be kept clean and free from effluvia arising from any drain, privy or other nuisance, and in particular-

**a.** accumulation of dirt and refuse shall be removed daily by sweeping or by any other effective method from the floors and benches of workrooms and from staircases and passages, and disposed of in a suitable manner;

**b.** the floor of every workroom shall be cleaned at least once in every week by washing, using disinfectant, where necessary, or by some other effective method;

**c.** Where a floor is liable to become wet in the course of any manufacturing process to such extent as is capable of being drained, effective means of drainage shall be provided and maintained;

**d.** all inside walls and partitions, all ceilings or tops of rooms and all walls, sides and tops of passages and staircases shall-

i. where they are painted otherwise than with washable water-paint or varnished, be repainted or revarnished at least once in every period of five years;

Where they are painted with washable water-paint, be repainted with at least one coat of such paint at least once in every period of three years and washed at least once in every period of six months;

ii. where they are painted or varnished or where they have smooth impervious surfaces, be cleaned at least once in every period of fourteen months by such method as may be prescribed;

iii. in any other case, be kept whitewashed or colour washed, and the whitewashing or colour washing shall be carried out at least once in every period of fourteen months.

**e.** all doors and window frames and other wooden or metallic framework and shutters shall be kept painted or varnished and the painting or varnishing shall be carried out at least once in every period of five years;

**f.** the dates on which the processes required by clause (d) are carried out shall be entered in the prescribed register

**Power of State Government to exempt:** If the State Government finds that a particular factory cannot comply with the above requirements due to its nature of manufacturing process, it may exempt the factory from the compliance of these provisions and suggest some alternative method for keeping the factory clean.

ii. **Disposal of wastes and effluents (Section 12)**

Every occupier of a factory shall make effective arrangements for the treatment of wastes and effluents due to the manufacturing process carried on in the factory so as to render them innocuous and for their disposal. Such arrangements should be in accordance with the rules, if any, laid down by the State Government. If the State

Government has not laid down any rules in this respect, arrangements made by the occupier should be approved by the prescribed authority, if required by the State Government.

iii. **Ventilation and temperature (Section 13)**

Section 13 provides that every factory should make suitable and effective provisions for securing and maintaining

a. adequate ventilation by the circulation of fresh air; and
b. such a temperature as will secure to the workers reasonable conditions of comfort and prevent injury to health.

**Measures to reduce excessively high temperature:** To prevent excessive heating of any workroom following measures shall be adopted:

i. walls and roofs shall be of such material and so designed that such temperature shall not be exceeded but kept as low as practicable;
ii. where the nature of the work carried on in the factory involves, or is likely to involve, the production of excessively high temperatures, such adequate measures as are practicable shall be taken to protect the workers there from, by separating the process which produces such temperatures from the workroom, by insulating the hot parts or by other effective means.

The Chief Inspector is empowered to direct any factory to adopt such methods which will reduce the excessively high temperature. In this regard, he can specify the measures which in his opinion should be adopted.

iv. **Dust and fume (Section 14)**

There are certain manufacturing processes like chemical, textile or jute, etc., which generates lot of dust, fume or other impurities. It is injurious to the health of workers employed in such manufacturing process.

Therefore, section 14 provides for the following measures to be adopted in this respect:

- Effective measures should be taken to prevent the inhalation and accumulation of dust, fumes etc., in the work-rooms.
- Wherever necessary, an exhaust appliances should be fitted, as far as possible, to the point of origin of dust fumes or other impurities.
- In cases of other internal combustion engine, effective measures should be taken to prevent the accumulation of fumes therefrom.

It may be pointed that the evidence of actual injury to health is not necessary. If the dust or fume by reason of manufacturing process is given off in such quantity that it is injurious or offensive to the health of the workers employed therein, the offence is committed under this Section. The offence committed is a continuing offence.

v. **Overcrowding (Section 16)**

Overcrowding in the work-room does not only affect the workers in their efficient discharge of duties but their health also. Section 16 has been enacted with a view to provide sufficient air space to the workers. The section prohibits the overcrowding in the work-rooms to the extent it is injurious to the health of the workers. Apart from this general prohibition, the section lays down minimum working space for each worker

as 14.2 cubic metres of space per worker in every workroom. For calculating the work area, the space more than 4.2 metres above the level of the floor, will not be taken into consideration.

**vi. Lightening (Section 17)**

Section 17 made it mandatory to provide and maintain sufficient and suitable lighting, natural or artificial, or both in every part of a factory where workers are working or passing. In every factory all glazed windows and skylights used for the lighting of the workroom shall be kept clean on both the inner and outer surfaces and so far as compliance with the provisions of any rules made under section 13 will allow, free from obstruction. In every factory effective provision shall, so far as is practicable, be made for the prevention of-

**a.** glare, either directly from a source of light or by reflection from a smooth or polished surface;

**b.** the formation of shadows to such an extent as to cause eye-strain or the risk of accident to any worker.

**vii. Drinking water (Section 18)**

Section 18 deals with the provisions relating to arrangements for drinking water in factories. It provides that in every factory effective arrangements shall be made to provide and maintain at suitable points conveniently situated for all workers employed therein a sufficient supply of wholesome drinking water. All such points shall be legibly marked "drinking water" in a language understood by a majority of the workers employed in the factory, and no such point shall be situated within six meters of any washing place, urinal, latrine, spittoon, open drain carrying sullage or effluent or any other source of contamination] unless a shorter distance is approved in writing by the Chief Inspector.

In every factory wherein more than 250 workers are ordinarily employed, provisions shall be made for cooling drinking water during hot weather by effective means and for distribution thereof. In respect of all factories or any class or description of factories the State Government may make rules for securing compliance with the provisions of this section and for the examination by prescribed authorities of the supply and distribution of drinking water in factories.

**viii. Latrines and urinals (Section 19)**

The section made it mandatory that in every factory-

a. sufficient latrine and urinal accommodation of prescribed types shall be provided conveniently situated and accessible to workers at all times while they are at the factory;

b. separate enclosed accommodation shall be provided for male and female workers;

c. such accommodation shall be adequately lighted and ventilated, and no latrine or urinal shall, unless specially exempted in writing by the Chief Inspector, communicate with any workroom except through an intervening open space or ventilated passage;

d. all such accommodation shall be maintained in a clean and sanitary condition at all times;

e. sweepers shall be employed whose primary duty it would be to keep clean latrines, urinals and washing places.

For the factories employing more than 250 workers ordinarily, there shall be provided all latrine and urinal accommodation of prescribed sanitary types; the floors and internal walls, up to a height of 90 cms, of the latrines and urinals and the sanitary blocks shall be laid in glazed tiles or otherwise finished to provide a smooth polished impervious surface; the floors, portions of the walls and blocks so laid or finished and the sanitary pans of latrines and urinals shall be thoroughly washed and cleaned at least once in every seven days with suitable detergents or disinfectants or with both.

**ix. Spittoons (Section 20)**

According to the section, there shall be provided, in every factory, a sufficient number of spittoons in convenient places and they shall be maintained in a clean and hygienic condition.

The State Government may make rules prescribing the type and the number of spittoons to be provided and their location in any factory and provide for such further matters relating to their maintenance in a clean and hygienic condition.

A notice containing the provision shall be prominently displayed at suitable places in the premises that no person shall spit within the premises of a factory except in the Spittoons provided for the purpose.

## Safety

Chapter IV of the Act contains provisions relating to safety. These are discussed below:

**I. Fencing of machinery (Section 21)**

According to the section, fencing of machinery in use or in motion is obligatory. This Section requires that following types of machinery or their parts, while in use or in motion, shall be securely fenced by safeguards of substantial construction and shall be constantly maintained and kept in position, while the parts of machinery they are fencing are in motion or in use. Such types of machinery or their parts are:

i. every moving part of a prime mover and every flywheel connected to a prime mover, whether the prime mover or flywheel is in the engine house or not;
ii. the headrace and tailrace of every water-wheel and water turbine;
iii. any part of a stock-bar which projects beyond the head stock of a lathe; and
iv. unless they are in such position or of such construction as to be safe to every person employed in the factory as they would be if they were securely fenced, the following, namely -
    a) every part of an electric generator, a motor or rotary convector;
    b) every part of transmission machinery; and
    c) every dangerous part of any other machinery;

It is provided that for the purpose of determining whether any part of machinery is in such position or is of such construction as to be safe as aforesaid, account shall not be taken of any occasion when –

(i) it is necessary to make an examination of any part of the machinery aforesaid while it is in motion or, as a result of such examination, to carry out lubrication or other adjusting operation while the machinery is in motion, being an examination or operation which it is necessary to be carried out while that part of the machinery is in motion, or

(ii) in the case of any part of a transmission machinery used in such process as may be prescribed (being a process of a continuous nature the carrying on of which shall be, or is likely to be, substantially interfered with by the stoppage of that part of the machinery), it is necessary to make an examination of such part of the machinery while it is in motion or, as a result of such examination, to carry out any mounting or shipping of belts or lubrication or other adjusting operation while the machinery is in motion, and such examination or operation is made or carried out in accordance with the provisions section 22.

The State Government may by rules prescribe such further precautions as it may consider necessary in respect of any particular machinery or part thereof, or exempt, subject to such condition as may be prescribed, for securing the safety of the workers, any particular machinery or part thereof from the provisions of this section.

**II. Work on or near machinery in motion (Section 22)**

Section 22 lays down the procedure for carrying out examination of any part while it is in motion or as a result of such examination to carry out the operations mentioned under Section 21. Such examination or operation shall be carried out only by specially trained adult male worker wearing tight fitting clothing (which shall be supplied by the occupier) whose name has been recorded in the register prescribed in this behalf and who has been furnished with a certificate of appointment and while he is so engaged. No woman or young person shall be allowed to clean, lubricate or adjust any part of a prime-mover or any transmission machinery while the prime-mover or transmission machinery is in motion or to clean, lubricate or adjust any part of any machine if the cleaning, lubrication and adjustment thereof would expose the woman or the young person to risk of injury from any moving part either of that machine or of any adjacent machinery.

**III. Employment of young persons on dangerous machines (Section 23)**

According to the section, any young person shall not be required or allowed to work at any machine to which this section applies, unless he has been fully instructed as to the dangers arising in connection with the machine and the precautions to be observed and-

- has received sufficient training in work at the machine, or
- is under adequate supervision by a person who has a thorough knowledge and experience of the machine.

**IV. Floors, stairs and means of access (Section 32)**

The section provides that in every factory

- all floors, steps, stairs passages and gangways shall be of sound construction and properly maintained and shall be kept free from obstruction and substances likely to cause persons to slip and where it is necessary to ensure safety, steps, stairs passages and gangways shall be provided with substantial handrails,

- there shall, be so far as is reasonably practicable, be provided, and maintained safe means of access of every place at which any person is at any time required to work;
- when any person has to work at a height from where he is likely to fall, provision shall be made, so far as is reasonably, practicable, by fencing or otherwise, to ensure the safety of the person so working.

**V. Protection of eyes (Section 35)**

The section requires the State Government to make rules and require for providing the effective screens or suitable goggles for the protection of persons employed on or in immediate vicinity of any such manufacturing process carried on in any factory which involves:

- risk of injury to the eyes from particles or fragments thrown off in the course of the process or;
- risk to the eyes by reason of exposure to excessive light.

**VI. Precautions against dangerous fumes, gases, etc. (Section 36)**

In order to prevent the factory workers against dangerous fumes, special measures have been taken under the Factories Act. The Act prohibits entry in any chamber, tank, vat, pit, pipe, flue, or other confined space in any factory in which any gas, fume, vapour or dust is likely to be present, to such an extent as to involve risk to persons being overcome thereby, except in cases where there is a provision of a manhole of adequate size or other effective means of egress. [Section 36 (1)].

No person shall be required or allowed to enter any confined space such as is referred to in sub-section (1) until all practicable measures have been taken to actually remove the gas, fumes or dust, which may be present so as to bring its level within the permissible limits and to prevent any ingress of such gas, fume, vapour or dust and unless:

- a certificate in writing has been given by a competent person, based on a test carried out by himself that the space is reasonably free from dangerous gas, fume, vapour or dust; or
- such person is wearing suitable breathing apparatus and a belt securely attached to a rope, the free end of which is held by a person outside the confined space. [Section 36 (2)].

**VII. Precautions regarding the use of portable electric light (Section 36-A)**

The Act prohibits use of portable electric light or any other electric appliance of voltage exceeding 24 volts inside any chamber, tank, vat, pit, pipe, flue or other confined space in any factory unless adequate safety devices are provided; and if any inflammable gas, fume or dust is likely to be present in such chamber, tank, vat, pit, pipe, flue or other confined space ,no lamp or light other than that of flame proof construction shall be permitted to be used therein unless adequate safety devices are provided.

**VIII. Explosive or inflammable dust, gas, etc. (Section 37)**

The section provides for mandatory requirement to take all practicable measure in every factory where any manufacturing process produces dust, gas, fume or vapour of

such character and to such extent to be likely to explode on ignition, to prevent any such explosion. These practical measures include

- effective enclosure of the plant or machinery used in the process,
- removal or prevention of the accumulation of such dust, gas fume or vapour, and
- exclusion or effective enclosure of all possible sources of ignition.

**IX. Precautions in case of fire (Section 38)**

In every factory all practicable measures shall be taken to prevent outbreak of fire and its spread, both internally and externally and to provide and maintain

- safe means of escape for all persons in the event of fire, and
- the necessary equipment and facilities for extinguishing fire.

Effective measures shall be taken to ensure that in every factory all the workers are familiar with the means of escape in case of fire and have been adequately trained in the outline to be followed in such case.

**X. Power to require specifications of defective parts or tests of stability (Section 39)**

If it appears to the Inspector that any building or part of a building or any part of the ways, machinery or plant in a factory is in such a condition that it may be dangerous to human life or safety, he may serve on the occupier or manager or both of the factory an order in writing requiring him before a specified date-

- to furnish such drawings, specifications and other particulars as may be necessary to determine whether such buildings, ways, machinery or plant can be used with safety, or
- to carry out such tests in such manner as may be specified in the order, and to inform the Inspector of the results thereof.

**XI. Safety of buildings and machinery (Section 40)**

If it appears to the Inspector that any building or part of a building or any part of the ways, machinery or plant in a factory is in such a condition that it is dangerous to human life or safety, he may serve on the occupier or manager or both of the factory an order in writing specifying the measures, which in his opinion should be adopted and requiring them to be carried out before a specified date.

If it appears to the Inspector that the use of any building or part of a building or any part of the ways, machinery or plant in a factory involves imminent danger to human life or safety he may serve on the occupier or manager or both of the factory an order in writing prohibiting its use until it has been properly repaired or altered.

**XII. Maintenance of buildings (Section 40-A)**

If it appears to the Inspector that any building or part of a building in a factory is in such a state of disrepair as is likely to lead to conditions detrimental to the health and welfare of the workers, he may serve on the occupier or manager or both of the factory an order in writing specifying the measures which in his opinion should be taken and requiring the same to be carried out before such date as is specified in the order.

## XIII. Safety Officers (Section 40-B)

If State Government requires, by notification in Official Gazette, the occupier shall employ such number of Safety Officers as may be specified in that notification in every factory-

- wherein 1000 or more workers are ordinarily employed, or
- wherein, in the opinion of the State Government, any manufacturing process or operation is carried on, which process or operation involves any risk of bodily injury, poisoning or disease or any other hazard to health, to the person employed in the factory.

The duties, qualifications and conditions of service of Safety Officers shall be such as may be prescribed by the State Government.

## Constitution of Site Appraisal Committees (Section 41A)

The State Government may, for purposes of advising it to consider applications for grant of permission for the initial location of a factory involving a hazardous process or for the expansion of any such factory, appoint a Site Appraisal Committee. The Committee shall examine an application for the establishment of a factory involving hazardous process and make its recommendation to the State Government within a period of 90 days of the receipt of such application in the prescribed form.

Where any process relates to a factory owned or controlled by the Central Government or to a corporation or a company owned or controlled by the Central Government, the State Government shall co-opt in the Site Appraisal Committee a representative nominated by the Central Government as a member of that Committee. The Committee shall have power to call for any information from the person making an application for the establishment or expansion of a factory involving a hazardous process.

## Compulsory disclosure of Information by the Occupier (Section 41B)

The occupier of every factory involving a hazardous process shall disclose in the manner prescribed, all information regarding dangers including health hazards and the measures to overcome such hazards arising from the exposure to or handling of the materials or substances in the manufacture, transportation, storage and other processes, to the workers employed in the factory, the Chief Inspector, the local authority, within whose jurisdiction the factory is situate, and the general public in the vicinity. The information furnished shall include accurate information as to the quantity, specifications and other characteristics of wastes and the manner of their disposal.

The occupier shall, at the time of registering the factory involving a hazardous process lay down a detailed policy with respect to the health and safety of the workers employed therein and intimate such policy to the Chief Inspector and the local authority and, thereafter inform the Chief Inspector and the local authority of any change made in the said policy.

Every occupier shall, with the approval of the Chief Inspector, draw up an on-site emergency plan and detailed disaster control measures for his factory and make known to the workers employed therein and to the general public living in the vicinity of the factory, the safety measures required to be taken in the event of an accident taking place.

Every occupier of a factory shall inform the Chief Inspector of the nature and details of the process in such form and in such manner as may be prescribed if

- such factory is engaged in a hazardous process on the commencement of the Factories (Amendment) Act, 1987 within a period of 30 days of such commencement; and
- if such factory purposes to engage in a hazardous process at any time after such commencement, within a period of 30 days before the commencement of such process.

## Specific responsibility of the occupier in relation to hazardous processes (Section 41C)

Every occupier of a factory involving any hazardous process shall maintain accurate and up-to-date health records or, as the case may be, medical records, of the workers in the factory who are exposed to any chemical, toxic or any other harmful substances which are manufactured, stored, handled or transported and such records shall be accessible to the workers subject to such conditions as may be prescribed.

Such occupier shall appoint persons who possess qualifications and experience in handling hazardous substances and are competent to supervise such handling within the factory and to provide at the working place all the necessary facilities for protecting the workers in the manner prescribed. It is provided that where any question arises as to the qualifications and experience of a person so appointed, the decision of the Chief Inspector shall be final.

Such occupier shall provide for medical examination of every worker-

- before such worker is assigned to a job involving the handling of, or working with, a hazardous substance, and
- while continuing in such job, and after he has ceased to work in such job, at intervals not exceeding twelve months in such manner as may be prescribed,

## Power of Central Government to appoint Inquiry Committee (Section 41D)

The Central Government may, in the event of the occurrence of an extraordinary situation involving a factory engaged in a hazardous process, appoint an Inquiry Committee to inquire into the standards of health and safety observed in the factory with a view to finding out the causes of any failure or neglect in the adoption of ally measures or standards prescribed for the health and safety of the workers employed in the factory or the general public affected, or likely to be affected, due to such failure or neglect and for the prevention and recurrence of such extraordinary situations in future in such factory or elsewhere.

The recommendations of the Committee shall be advisory in nature.

## Emergency Standards (Section 41E)

Where the Central Government is satisfied that no standards of safety have been prescribed in respect of a hazardous process or class of hazardous processes, or where the standards so prescribed are inadequate, it may direct the Director-General of Factory advice Service and Labour Institutes or any Institution specialised in matters relating to standards of safety in hazardous processes, to lay down emergency standards for enforcement of suitable standards in respect of such hazardous processes.

## Permissible limits of exposure of chemical and toxic substances (Section 41F)

The maximum permissible threshold limits of exposure of chemical and toxic substances in manufacturing processes (whether hazardous or otherwise) in any factory shall be of the value indicated in the 2nd Second Schedule.

## Workers' participation in safety management (Section 41G)

The section provides for constitution of Safety Committee consisting of equal number of representatives of workers and management. Such Safety Committee shall be set up by the occupier in every factory where a hazardous process takes place, or where hazardous substances are used or handled. The functions of the Safety Committee are to promote co-operation between the workers and the management in maintaining proper safety and health at work and to review periodically the measures taken in that behalf.

## Right of workers to warn about imminent danger (Section 41H)

Where the workers employed in any factory engaged in a hazardous process have reasonable apprehension that there is a likelihood of imminent danger to their lives or health due to any accident, they may, bring the same to the notice of the occupier, agent, manager or any other person who is in-charge of the factory or the process concerned directly or through their representatives in the Safety Committee and simultaneously bring the same to the notice of the Inspector. It shall be the duty of such occupier, agent, manager or the person incharge of the factory or process to take immediate remedial action if he is satisfied about the existence of such imminent danger and send a report forth-with of the action taken to the nearest Inspector.

If the occupier, agent, manager or the person in-charge is not satisfied about the existence of any imminent danger as apprehended by the workers, he shall, nevertheless, refer the matter forth-with to the nearest Inspector whose decision on the question of the existence of such imminent danger shall be final.

# Welfare

## Washing Facilities (Section 42)

In every factory, there shall be provided –

- adequate and suitable facilities for washing shall be provided and maintained for use of the workers therein;
- separate and adequately screened facilities shall be provided for the use of male and female workers;
- such facilities shall be conveniently accessible and shall be kept clean.

## Facilities for storing and drying clothing (Section 43)

The State Government may make rules requiring the provision therein of suitable place for keeping clothing not worn during working hours and for the drying of wet clothing

## Facilities for sitting (Section 44)

There shall be suitable arrangements for sitting in every factory and they shall be maintained for all workers obliged to work in a standing position. The provision ensures such worker may take advantage of any opportunities for rest which may occur in the course of their work.

If, in the opinion of the Chief Inspector, the workers in any factory engaged in a particular manufacturing process or working in a particular room, are able to do their work efficiently in a sitting position, he may, by order in writing, require the occupier of the factory to provide before a specified date such seating arrangements as may be practicable for all workers so engaged or working.

## First-aid appliances (Section 45)

In every factory, there shall be provided and maintained so as to be readily accessible during all working hours' first-aid boxes or cupboards equipped with the prescribed contents.

At least one such box or cupboard shall be provided and maintained for every 150 workers ordinarily employed at any one time in the factory. It is also mandatory that nothing except the prescribed contents shall be kept in a first-aid box or cupboard.

Each first-aid box or cupboard shall be kept in the charge of a separate responsible person, who holds a certificate in first-aid treatment recognized by the State Government and who shall always be readily available during the working hours of the factory. There shall be provided and maintained an ambulance room of the prescribed size, containing the prescribed equipment in every factory wherein more than 500 are ordinarily employed. The ambulance shall be in the charge of such medical and nursing staff as may be prescribed and those facilities shall always be made readily available during the working hours of the factory.

## Canteens (Section 46)

The State Government may make rules requiring that the occupier shall provide and maintain a canteen or canteens for the use of the workers in any specified factory wherein more than 250 workers are ordinarily employed. Without prejudice in the generality of the foregoing power, such rules may provide for-

**a.** the date by which such canteen shall be provided;

**b.** the standard in respect of construction, accommodation, furniture and other equipment of the canteen;

**c.** the foodstuffs to be served therein and the charges which may be made therefor;

**d.** the constitution of a managing committee for the canteen and representation of the workers in the management of the canteen;

**dd.** the items of expenditure in the running of the canteen which are not to be taken into account in fixing the cost of foodstuffs and which shall be borne by the employer;

## Shelters, rest-rooms and lunch-rooms (Section 47)

It is mandatory to provide and maintain adequate and suitable shelters or rest-rooms and a suitable lunch-room, with provision for drinking water, where workers can eat meals brought by them in every factory wherein more than 150 workers are ordinarily employed.

It is provided that any canteen maintained in accordance with the provisions of section 46 shall be regarded as part of the requirements of this section. It is also provided further that where a lunch-room exists no worker shall eat any food in the work-room.

The shelters or rest-room or lunch-room to be provided shall be sufficiently lighted and ventilated and shall be maintained in a cool and clean condition. The State Government may:

a) prescribe the standards, in respect of construction accommodation, furniture and other equipment of shelters, rest-rooms and lunch-rooms to be provided under this section;
b) by notification in the Official Gazette, exempt any factory or class or description of factories from the requirements of this section.

## Creches (Section 48)

It is compulsory to provide and maintain a suitable room or rooms for the use of children under the age of 6 years of women in every factory wherein more than 30 women workers are ordinarily employed. Such rooms shall provide adequate accommodation, shall be adequately lighted and ventilated, shall be maintained in a clean and sanitary condition and shall be under the charge of women trained in the care of children and infants.

# Law of Welfare & Working Condition

## Unit II – The Contract Labour (Regulation and Abolition) Act, 1970

### History of the Legislation

Contract Labour has its root from time immemorial but the size of contract labour in India has significantly expanded in the post-independence period with the expansion of construction activity following substantial investment in the Plans. During the early period of industrialisation, the industrial establishments were always faced with the problems of labour recruitment. Low status of factory workers, lack of labour mobility, caste and religious taboo, language, etc., were some of the problems with which most of the employers in general and British employers or their epresentatives, in particular were not familiar. They were unable to solve these problems. Therefore, they had to depend on middlemen who helped them in recruitment and control of labour. These middlemen or contractors were known by different names in various parts of the country. Contract Labourers were considered as exploited section of the working class mainly due to lack of organisation on their part. Due to this, the Whitley Commission (1860) recommended the abolition of contract labour by implication. Before 1860, in addition to the many disadvantages suffered by the contract labour, the Workman's Breach of Contract Act 1859 operated in holding them criminally responsible in the event of a breach of contract service.

Following this, the Government constituted various committees to study the socio-economic conditions of contract labours, e.g., The Bombay Textile Labour Enquiry Committee (1938), The Bihar Labour Enquiry Committee (1941), The Rega Committee (1946). As a result of recommendations of these committees, the scope of the definition of "workers" in the Factories Act (1948), the Mines Act (1952) and the Plantations Labour Act (1951), was enlarged to include contract labour.

In the Second Five Year Plan, the Planning Commission stressed the need of improvement in the working conditions of contract labour and thus, recommended for a special treatment to the contract labour so as to ensure them continuous mployment where it was not possible to abolish such type of labour. It was discussed at various meetings of Tripartite Committees at which the State Governments were also represented and the general consensus of opinion was that the system of contract should be abolished wherever possible and practicable and that in case where this system could not be abolished althogether, the working conditions of contract labour should be regulated so as to ensure payment of wages and provision of essential amenities. Based on these views "The Contract Labour (Regulation and Abolition) Act, 1970" was passed by both the Houses of Parliament and received the assent of the President on 5th September, 1970 and it came into force from 10th February, 1971. The Contract Labour (Regulation and Abolition) Central Rules, 1971 were also notified for enforcement of the Act.

## Object and Scope of the Act

The preamble of the Act states that it is an Act to regulate the employment of contract labour in certain establishments and to provide for its abolition in certain circumstances and for matters connected therewith.

In Gammon India Ltd. vs. Union of India, (1974-I-LU-489) the Supreme Court while dealing with the object for which the Contract Labour (Regulation and Abolition) Act, 1970 was enacted observed that the Act was passed to prevent the exploitation of contract labour and also to introduce better conditions of work. The Act provides for regulation and abolition of contract labour. The underlying policy of the Act is to abolish contract labour, whenever possible and practicable, and where it cannot be abolished, the policy of the Act is that the working conditions of the contract labour should be so regulated as to ensure payment of wages and provisions of essential amenities.

In exercise of the powers conferred by section 35 of the Contract Labour (Regulation and Abolition) Act, 1970 the Central Government made the rules, "The Contract Labour (Regulation and Abolition) Central Rules, 1971.

According to section 1, the Act extends to the whole of India. It applies —

**a.** to every establishment in which twenty or more workmen, are employed or were employed on any day of the preceding twelve months as contract labour ;
**b.** to every contractor who employs or who employed on any day of the preceding twelve months twenty or more workmen.

However, the appropriate Government may, after giving not less than two months' notice of its intention so to do, by notification in the Official Gazette, apply the provisions of this Act to any establishment or contractor employing such number of workmen less than twenty as may be specified in the notification.

Where the dispute relates to service conditions of the workmen engaged in the factory canteen maintained by the company and there is no question of abolition of contract labour, the dispute can be referred to the industrial Tribunal for adjudication [Indian Explosives Ltd. v. State of u.P., (1981) 1 LU 423 (All H.C.)].

According to section 1(5), the Act is not applicable to establishments in which work only of an intermittent or casual nature is performed. If a question arises whether work performed in an establishment is of an intermittent or casual nature, the appropriate Government shall decide that question after consultation with the Central Board or, as the case may be, a State Board, and its decision shall be final.

**Explanation-** For the purpose of this sub-section, work performed in an establishment shall not be deemed to be of an intermittent nature - (i) if it was, performed for more than one hundred and twenty days in the preceding twelve months, or (ii) if it is of a seasonal character and is performed for more than sixty days in a year.

## Definitions

According to section 2(1) — In this Act, unless the context otherwise requires, —

**'Appropriate Government'** means -

a. in relation to an establishment in respect of which the appropriate Government under the Industrial Disputes Act, 1947, is the Central Government;
b. in relation to any other establishment, the Government of the State in which that other establishment is situated. [Section 2(1)(a)]

**"Contract Labour"**

A workman shall be deemed to be employed as "contract labour" in or in connection with the work-of an establishment when he is hired in or in connection with such work by or through a contractor, with or without the knowledge of the principal employer. [Section 2(1)(b)]

"Contract labour" can be distinguished from employees in terms of employment relationship with the principal establishment and the method of wage payment. A workman is deemed to be a contract labour when he/she is hired in connection with the work or contract for service of an establishment by or through a contractor. They are indirect employees. Contract labour is neither borne on pay roll or muster roll or wages paid directly to the employer.

**"Contractor"**

Contractor in relation to an establishment, means- a person

- who undertakes to produce a given result for the establishment, other than a mere supply of goods or articles of manufacture to such establishment, through contract labour; or
- who supplies contract labour for any work of the establishment and includes a sub-contractor. [Section 2(1)(c)
  - Contractor engaged for Section 2 (1)(c) covers construction of building. Gammon India Ltd. v. Union of India, (1974) 1 SCC 596: 1971 SCC (L & S) 252.
  - Section 2 (1)(c)-'Contractor' is one who supplies contract labour to an establishment undertaking to produce a given result for it. He hires labour in connection with the work of an establishment. State of Gujarat v. Vogue Garments, (1983) 1 LU 255: 1983 Lab IC 129 (Guj HC).
  - Section 2 (1) (c)-Sub-contractors or 'piece wagers', are contractors [Labourers Working on Salal Hydro Project v. State of J&K, (1983)/2 SCG 181).

**"Controlled Industry"**

Controlled industry means any industry the control of which by the Union has been declared by any Central Act to be expedient in the public interest. [Section 2(1)(d)]

**"Establishment"**

Establishment means –

a. any office or department of the Government or a local authority, or -
b. any place where any industries, trade, business, manufacture or occupation is carried on. [Section 2(1)(e)]

Section 2 (1)(e)(ii) - A ship or vessel in which repair work is carried on is a place and an "establishment" within the meaning of Section 2 (1) (e) (ii). The work site or place may or may not belong to the principal employer, but that will not stand in the way of application of the Act or in holding that a particular place or work site where industry, trade, business, manufacture or occupation is carried on is not an establishment. Lionel Edwards Led. v. Labour Enforcement Officer, (1977) 51 FJR 199 (Cal).

Section 2(1)(e)(ii)-Any object for the time being covering the surface and where industry, trade, business, manufacture or occupation is carried on would be a place and an "establishment" within the meaning of Section 2 (1) (e) (ii).

## "Principal Employer"

Principal employer means –

**a.** in relation to any office or department of the Government or a local authority, the head of that office or department or such other officer as "'the Government or the local authority, as the case may be, may specify in this behalf,

**b.** in a factory, the owner or occupier of the factory and where a person has been named as the manager of the factory under the Factories Act, 1948 ,the person so named.

**c.** in a mine, the owner or agent of the mine and where a person has been named as the manager of the mine, the person so named,

**d.** in any other establishment, any person responsible for the supervision and control of the establishment [Section 2(1)(g)]

**Explanation. -** For the purpose of sub-clause (iii) of this clause expressions mine", "owner" and "agent" shall have the meanings respectively assigned to them in clause (j), clause (1) and clause (c) of sub-section (1) of Section 2 of the 'Mines Act, 1952;

## "Occupier"

Occupier of a factory under section 2(n) of the Factories Act; 1948 means the person who has ultimate control over the affairs of the factory, and where the said affairs are entrusted to a managing agent, such agent shall be deemed to be the occupier of the factory.

## "Wages"

Wages shall have the meaning assigned to it in clause (vi) of Section 2 of the Payment of Wages Act, 1936.[Section 2(1)(h)]

## "Workman"

Workman means any person employed in or in connection with the work of any establishment to do any skilled, semi-skilled or un-skilled manual, supervisory, technical or clerical work for hire or reward, whether the terms of employment be express or implied, but does not include any such person-

**a.** who is employed mainly in a managerial or administrative capacity; or

**b.** who, being employed in a supervisory capacity draws wages exceeding five hundred rupees per mensem or exercises, either by the nature of the duties attached to the office or by reason of the powers vested in him functions mainly of a managerial nature; or

**c.** who is an out worker, that is to say, a person to whom any articles and materials are given out by or on behalf of' the principal employer to be made up, cleaned, washed, altered, ornamented, finished, repaired, adapted or otherwise processed for sale for the purposes of the trade or business of the principal employer and the process is to be carried out either in the home of the out-worker or in some other premises, not being premises under the control and management of the principal employer. [Section 2(1)(i)]

## ADVISORY BOARDS

### 1) Central Advisory Board

Constitution of Central Board: In pursuance to the provisions of section 3, the Central Government shall, constitute a board to be called the Central Advisory Contract Labour Board (hereinafter referred to as the Central Board).

Function of the Central Board: The Central Board shall perform function of advising the Central Government on such matters arising out of the administration of this Act as may be referred to it and to carry out other functions assigned to it under this Act.

Composition of the Central Board: The Central Board shall consist of-

**a.** a Chairman to be appointed by the Central Government;
**b.** the Chief Labour Commissioner (Central), ex officio;
**c.** such number of members, not exceeding seventeen but not less than eleven, as the Central Government may nominate to represent that Government, the Railways, the coal industry, the mining industry, the contractors, the workmen an any other interests which, in the opinion of the Central Government ought to be represented on the Central Board.

The number of persons to be appointed and members from each of the categories specified above, the term of office and other conditions of service of, the procedure to be followed in the discharge of their functions by, and the manner of filling vacancies among, the members of the Central Board shall be such as may be prescribed .

Provided that the number of members nominated to represent the workmen shall not be less than the number of members nominated to represent the principal employers and the contractors.

### 2) State Advisory Board

Constitution of the State Board: Section 4 empowers the State Government to constitute a board to be called the State Advisory Contract-Labour Board (hereinafter referred to as the State Board).

Note: It is mandatory for the Central Government to constitute the Central Board u/s 3 of the Act while it is discretionary for the State Government to constitute the State Board u/s 4 of the Act.

**Function of State Board:** The State Board is constituted to advise the State Government on such matters arising out of the administration of this Act as may be referred to it and to carry out other functions assigned to it under this Act.

**Composition of the State Board:** The State Board shall consist of —

a. a Chairman to be appointed by the State Government;
b. the Labour Commissioner, ex officio, or in his absence any other officer nominated by the State Government in that behalf;
c. such numbers, not exceeding eleven but not less than nine, as the State Government may nominate to represent that Government, the industry, the contractors, the workmen and any other interests which, in the opinion of the State Government, ought to be represented on the State Board.

The number of persons to be appointed as members from each of the specified categories, the term of office and other conditions of service of, the procedure to be followed in the discharge of their functions by, and the manner of filling vacancies among, the members of the State Board shall be such as may be prescribed. However, it is provided that the number of members nominated to represent the workmen shall not be less than the number of members nominated to represent the principal employers and the contractors.

**3) Power to constitute committees**

According to section 5, the Central Board or the State Board, as the case may be, may constitute such committees and for such purpose or purposes as it may think fit. The committee shall meet at such time and places and shall observe such rules of procedure in regard to the transaction of business at its meetings as may be prescribed. The members of a committee shall be paid such fees and allowances for attending its meetings as may be prescribed:

Provided that no fees shall be payable to a member who is an officer of Government or of any corporation established by any law for the time being in force.

## Registration of Establishments Employing Contract Labour

1) **Appointment of Registering Officers:** According to section 6, the Appropriate Government may, by an order notified in the Official Gazette-
   a. appoint such persons, being Gazetted Officers of Government, as it thinks fit to be registering officers for the purposes of this Chapter; and
   b. define the limits, within which a registering officer shall exercise the powers conferred on him by or under this Act.
2) **Registration of certain establishment:** Section 7 makes it mandatory for every principal employer of an establishment to which this Act applies to make an application to the registering office in the prescribed manner for registration of the establishment. The appropriate Government may, by notification in the Official Gazette, fix time period for making such application with respect to establishments generally or with respect to any class of them. It is provided that the registering officer may entertain any such application for registration after expiry of the period fixed in this behalf, if the registering officer is satisfied that the applicant was prevented by sufficient cause from making the application in time.

If the application for registration is complete in all respects, the registering officer shall register the establishment and issue to the principal employer of the establishment a certificate of registration containing such particulars as may be prescribed.

3) **Revocation of registration in certain cases:** Section 8 provides that if the registering officer is satisfied, either on a reference made to him in this behalf or otherwise, that the registration of any establishment has been obtained by mis-representation or suppression of any material fact, or- that for any other reason the registration has become useless or ineffective and, therefore requires to be revoked, the registering officer may revoke the registration. He can do so only after giving an opportunity to the principal employer of the establishment to be heard and with the previous approval of the appropriate Government.

Rule 19 prescribes the circumstances in which application for registration may be rejected. —

a. If any application for registration is not complete in all respects, the registering officer shall require the principal employer to amend the application so as to make it complete in all respects.
b. If the principal employer, on being required by the registering officer to amend his application for registration, omits or fails to do so, the registering officer shall reject the application for registration.

4) **Effect of non-registration:** According to section 9, no principal employer of an establishment, to which this Act applies, shall employ contract labour in the establishment after the expiry of the period under section 7 in the case of the establishment which is required to be registered under Section 7, but which has not been registered within the time fixed for the purpose under that section.

The principal employer shall also not employ contract labour in the establishment after the revocation of registration of such establishment under Section 8.

5) **Prohibition of employment of contract labour:** According to section 10,the appropriate Government may, after consultation with the Central Board or, as the case may be, a State Board, prohibit, by notification in the Official Gazette, employment of contract labour in any process, operation or other work in any establishment. Section 10 vests overriding power in Appropriate Government irrespective of anything contained in the Act.

But before issuing any such notification in relation to an establishment, the appropriate Government shall have regard to the conditions of work and benefits provided for the contract labour that establishment and other relevant factors, such as-

a. whether the process, operation or other work is incidental to, or necessary for the industry, trade, business, manufacture or occupation that is carried on in the establishment;
b. whether it is of perennial nature, that is to say, it is so of sufficient duration having regard to the nature of industry, trade, business, manufacture or occupation carried on in that establishment;
c. whether it is done ordinarily through regular workmen in that establishment or an establishment similar thereto;

d. whether it is sufficient to employ considerable number of whole-time workmen.

**Explanation: -** If a question arises whether any process or operation or other work is of perennial nature, the decision of the appropriate Government thereon shall be final.

Apart from registration of establishments employing contract labour, the Act contains provisions for licensing of contractors. Section 11 empowers the appropriate Government to appoint Gazetted Officers to be licensing officers and define the limits of their jurisdiction. Orders regarding appointment of licensing officers and the limits of their jurisdiction are to be notified in the Official Gazette.

1) **Appointment of licensing officers:** According to section 11,the appropriate Government may, by an order notified in the Official Gazette,-(a) appoint such persons, being Gazetted Officers of Government, as it thinks fit to be licensing officers for the purposes of this Chapter ; and (b) define the limits, within which a licensing officer shall exercise the powers conferred on licensing officers by or under this Act.
2) **Licensing of contractors:** According to section 12, with effect from such date as the appropriate Government may, by notification in the Official Gazette, appoint, no contractor to whom this Act applies, shall undertake or execute any work through contract labour except under and accordance with a licence issued in that behalf by the licensing officer. Subject to the provisions of this Act, such a licence may contain such conditions including, in particular, conditions as to hours or work, fixation of wages and other essential amenities in respect of contract labour as the appropriate Government may deem fit to impose in accordance with the rules, if any, made under Section 35 and shall be issued on payment of such fees and on the deposit of such sum, If any, as security for the due performance of the conditions as may be prescribed.

## Welfare and Health of Contract Labour

I. **Canteens:** According to section 16, the appropriate Government may make rules requiring that one or more canteens shall be provided and maintained by the contractor for the use of such contract labour in every establishment-
   a. to which this Act applies,
   b. wherein work requiring employment of contract labour is likely to continue for such period as may be prescribed, and
   c. wherein contract labour numbering one hundred or more is ordinarily employed by a contract, one or more canteens shall be provided and maintained by the contractor for the use of such contract labour.

In addition to above, the appropriate Government may provide rules for -

a. the date by which the canteens shall be provided;
b. the number of canteens that shall be provided, and the standards in respect of construction, accommodation, furniture and other equipment of the canteens; and
c. the foodstuffs which may be served therein and the charges which may be made therefore.

II. **Rest-rooms:** According to section 17, it is mandatory for the contractor to provide and maintain for the use of the contract labour such number of rest-rooms or such other suitable alternative accommodation within such time as may be prescribed in every place wherein contract labour is required to halt at night in connection with the work of an establishment-

   a. to which this Act applies, and
   b. in which work requiring employment of contract labour is likely to continue for such period as may be prescribed, there shall be provided and maintained by the contractor.

   The rest-rooms or the alternative accommodation to be provided shall be sufficiently lighted and ventilated and shall be maintained in a clean and comfortable condition.

III. **Other facilities:** According to section 18, It shall be the duty of every contractor employing contract labour in connection with the work of an establishment to which this Act applies, to provide and maintain-

   **a.** a sufficient supply of wholesome drinking water for the contract labour at convenient places;
   **b.** a sufficient number of latrines and urinals of the prescribed types so situated as to be convenient and accessible to the contract labour in the establishment; and
   **c.** Washing facilities.

IV. **First-aid facilities**: According to section 19, there shall be provided and maintained by the contractor so as to be readily accessible during all working hours a first aid box equipped with the prescribed contents at every place where contract labour is employed by him.

V. **Liability of principal employer in certain cases:** According to section 20, If any amenity required to be provided under Section 16, Section 17, Section 18 or Section 19 for the benefit of the contract labour employed in an establishment is not provided by the contractor within the time prescribed therefor, such amenity shall be provided by the principal employer within such time as may be prescribed. All expenses incurred by the principal employer in providing the amenity may be recovered by the principal employer from the contractor either by deduction from any amount payable to the contractor under any contract or as a debt payable by the contractor.

   Section 20 & 21- Obligation to provide amenities conferred under the Act to the workers is on the principal employer. Government will be responsible for enforcement of those amenities where contractors engaged by it for executing its construction project fail to provide the amenities to its workers.

VI. **Responsibility for payment of wages:** Section 21 makes a contractor statutorily responsible for payment of wages to each worker employed by him as contract labour and such wages shall be paid before the expiry of such period as may be prescribed.

## Penalties and Procedures

a. **Obstructions: -** According to section 22, Whoever obstructs an inspector in the discharge of his duties under this Act or refuses or wilfully neglects to afford the inspector any reasonable facility for making any inspection, examination, inquiry or investigation authorised by or under this Act in relation to an establishment to which,

or a contractor to whom, this Act applies, shall be punishable with imprisonment for a term which may extend to three months, or with fine which may extend to five hundred rupees, or with both.

Section 22 also provides for that a person shall be punishable with imprisonment for a term which may extend to three months, or with fine which may extend to five hundred rupees, or with both if he wilfully refuses to produce on the demand of an inspector any register or other document kept in pursuance of this Act or prevents or attempts to prevent or does anything which he has reason to believe is likely to prevent any person from appearing before or being examined by an inspector acting in pursuance of his duties under the Act,

b. **Contravention of provisions regarding employment contract labour: -** Section 23 provides for that a person shall be punishable with imprisonment for a term which may extend to three months, or with fine which may/extend to one thousand rupees, or with both, if he contravenes any provision of this Act or of any rules made thereunder prohibiting, restricting or regulating the employment of contract labour, or contravenes any condition of a licence granted under this Act.

In the case of a continuing contravention with an additional fine which may extend to one hundred rupees for every day during which such contravention continues after conviction for the first such contravention.

S. 23 -Mere allegation of contravention is not sufficient. The complainant has to allege as to who are those persons who have contravened the prohibition of or restriction on the employment of contract labour. J.P. Gupta v. Union of India, 1981 Lab IC 641 (Pat HC).

c. **Other offences: -** According to section 24,If any person contravenes any of the provisions of this Act or of any rules made thereunder for which no other penalty is elsewhere provided, he shall be punishable with imprisonment for a term which may extend to three months, or with fine which may extend to one thousand rupees, or with both.

d. **Offences by companies: -** Section 25 provides for that if the person committing an offence under this Act is a company, the company as well as every person in charge of, and responsible to, the company for the conduct of its business at the time of commission of the offence shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly.

It is provided that nothing contained in this sub-section shall render any such person liable to any punishment if he proves that the offence was committed without his knowledge or that he exercised all due diligence to prevent the commission of such offence.

However, where an offence under this Act has been committed by a company and it is proved that the offence has been committed with the consent or connivance of, or that the commission of' the offence is attributable to any neglect on the part of any director, manager, managing agent or any other officer of the company, such director, manager, managing agent or such other officer shall also be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

**Explanation: -** For the purpose of this section-(a) "company" means any body corporate and includes a firm or other association of individuals; and (b) "director", in relation to a firm means a partner in the firm.

e. **Cognizance or offences: -** According to section 26, no court shall take cognizance of any offence under this Act except on a complaint made by, or with the previous sanction in writing of, the inspector and no court inferior to that of a Presidency Magistrate or a magistrate of the first class shall try any offence punishable under this Act.

f. **Limitation or prosecution: -** According to section 27, no court shall take cognizance of an offence punishable under this Act unless the complaint thereof is made within three months from the date on which the alleged commission of the offence came to the knowledge of an inspector.

It is provided that where the offence consists of disobeying a written order made by an inspector, complaint thereof may be made within six months of the date on which the offence is alleged to have been committed.

## Inspecting Staff

According to section 28, the appropriate Government may, by notification in the Official Gazette, appoint such persons as it thinks fit to be inspectors for the purposes of this Act, and define the local limits within which they shall exercise their powers under this Act.

Subject to any rules made in this behalf, an inspector may, within the local limits for which he is appointed-

a. enter, at all reasonable hours, with such assistance (if any), being persons in the service of the Government or any local or other public authority as he thinks fit, any premises or place where contract labour is employed, for the purpose of examining any register or record or notices required to be kept or exhibited by or under this. Act or rules made 'thereunder, and require the production thereof for inspection;
b. examine any person whom he finds in any such premises or place and who, he has reasonable cause to believe, is a workman employed therein ;
c. require any person giving out work and any workman, to give any information, which is in his power to give with respect to the names and addresses of the persons to, for and from whom the work is given out or received, and with respect to the payments to be made for the work ;
d. seize to take copies of such register, record of wages or notices or portions ,thereof as he may consider relevant in respect of an offence under this Act which he has reason to believe has been committed by the principal employer or contractor; and
e. exercise such other powers as may be prescribed.

Any person required to produce any document or thing or to give any information required by an inspector shall be deemed to be legally bound to do so within the meaning of Section 175 and Section 176 of the Indian Penal Code, 1860. The provisions of the Code of Criminal Procedure, 1898, shall, so far as may be, apply to any search or seizure under this section as they apply to any search or seizure made under the authority of a warrant issued under Section 98 of the said Code.

## Registers and Other Records to be Maintained

According to section 29, every principal employer and every contractor shall maintain such registers and records giving such particulars of contract labour employed, the nature of work performed by the contract labour, the rates of wages paid to the contract labour and such other particulars in such form as may be prescribed.

Every principal employer and every contractor shall keep exhibited in such manner as may be prescribed within the premises of the establishment where the contract labour is employed, notices in the prescribed form containing particulars about the hours of work, nature of duty and such other information as may be prescribed.

# Law of Welfare & Working Condition

## Unit III – The Child and Adolescent Labour (Prohibition and Regulation) Act, 1986

### Objective of the Act

The Child and Adolescent Labour (Prohibition & Regulation) Act, 1986 enacted

- to prohibit the engagement of children in all occupations and
- to prohibit the engagement of adolescents in hazardous occupations.

It extends to whole of India.

It prohibits employment of children in all occupations and processes to facilitate their enrolment in schools in view of the **Right of Children to Free and Compulsory Education Act, 2009** and to prohibits employment of adolescents in hazardous occupations and processes and to regulate the conditions of service of adolescents in line with the ILO (International Labour Organisation) Convention 138 on Minimum Age and Convention 182 on the Worst Forms of Child Labour.

### Definition

**Appropriate Government** means

| | |
|---|---|
| the Central Government | - in relation to an establishment under the control of the Central Government or<br>- a railway administration or<br>- a major port or<br>- a mine or<br>- oilfield |
| the State Government | in all other cases |

**Adolescent means** a person who has completed his 14th year of age but has not completed his 18th year.

**Child** means a person who has not completed his 14th year of age or such age as may be specified in the Right of Children to Free and Compulsory Education Act, 2009, whichever is more.

**Establishment** includes a shop, commercial establishment, workshop, farm, residential hotel, restaurant, eating house, theatre or other place of public amusement or entertainment.

**Occupier** in relation to an establishment or a workshop, means **the person who has the ultimate control over the affairs of the establishment or workshop.**

**Workshop** means any premises (including the precincts thereof) wherein any industrial process is carried on, but does not include any premises to which the provisions of Sec. 67 of the Factories Act, 1948 apply (No child who has not completed his fourteenth year shall be required or allowed to work in any factory).

* **Precincts** means areas within walls or perceived boundaries of a particular building or place.

## Prohibition of Employment of Children in any Occupations and Processes

Section 3 of the Act provides that no child shall be employed or permitted to work in any occupations or process except: -

**a)** helps his family or family enterprise, which is other than any hazardous occupations or processes set forth in the Schedule, after his school hours or during vacations;

**b)** works as an artist in an audio-visual entertainment industry, including advertisement, films, television serials or any such other entertainment or sports activities except the circus, subject to such conditions and safety measures, as may be prescribed.

However, no such work shall effect the school education of the child.

It may be noted that the expression:

**a)** "family" in relation to a child, means his mother, father, brother, sister and father's sister and brother and mother's sister and brother;

**b)** "family enterprise" means any work, profession, manufacture or business which is performed by the members of the family with the engagement of other persons;

**c)** "artist" means a child who performs or practices any work as a hobby or profession directly involving him as an actor, singer, sports person or in such other activity as may be prescribed relating to the entertainment or sports activities falling under clause (b) of sub-section (2)."

## Prohibition of Employment of adolescents in hazardous Occupations and Processes

Section 3A provides that no adolescent shall be employed or permitted to work in any of the hazardous occupations or processes set forth in the Schedule.

The hazardous occupations or processes set forth in the Schedule are as under:

- Mines.
- Inflammable substances or explosives.
- Hazardous process.

Explanation. – For the purposes of this Schedule, "hazardous process" has the meaning assigned to it in clause (cb) of the Factories Act, 1948.

* "hazardous process" means any process or activity in relation to an industry specified in the First Schedule where, unless special care is taken, raw materials used therein or the intermediate or finished products, bye-products, wastes or effluents thereof would:

- cause material impairment to the health of the persons engaged in or connected therewith, or
- result in the pollution or the general environment:

However, the Central Government may, by notification, specify the nature of the non-hazardous work to which an adolescent may be permitted to work under the Act.

## Hours and Period of Work

Section 7 provides that no adolescent shall be required or permitted to work in any establishment in excess of such number of hours, as may be prescribed for such establishment or class of establishments.

The period of work on each day shall be so fixed that no period shall exceed 3 hours and that no adolescent shall work for more than 3 hours before he has had an interval for rest for at least one hour.

The period of work of adolescent shall be so arranged that inclusive of his interval for rest, it shall not be spread over more than 6 hours, including the time spent in waiting for work on any day.

This section also stipulates that:

- No adolescent shall be permitted or required to work between 7 p.m. and 8 a.m.
- No adolescent shall be required or permitted to work overtime.
- No adolescent shall be required or permitted to work in, any establishment on any day on which he has already been working in another establishment.

## Weekly Holidays

As per section 8 every adolescent employed in an establishment is entitled in each week, a holiday of one whole day, which day shall be specified by the occupier in a notice permanently exhibited in a conspicuous place in the establishment and the day so specified shall not be altered by the occupier more than once in 3 months.

## Notice to inspector

Section 9 provides that every occupier in relation to an establishment who employs, or permits to work, any adolescent shall, within a period of thirty days from the date of such employment, send to the Inspector within whose local limits the establishment is situated, a written notice containing the particulars namely:

- The name and situation of the establishment;
- The name of the person in actual management of the establishment;
- The address to which communications relating to the establishment should be sent; and
- The nature of the occupation or process carried on in the establishment.

## Maintenance of Register

Section 11 states that every occupier in respect of adolescent employed or permitted to work in any establishment, shall maintain a register to be available for inspection by an Inspector at all times during working hours or when work is being carried on in any such establishment showing –

- the name and date of birth of every adolescent so employed or permitted to work;
- hours and periods of work of any such adolescent and the intervals of rest to which he is entitled;
- the nature of work of any such adolescent; and
- such other particulars as may be prescribed

## Display of Notice Containing Abstract of Sections 3A and 14

Section 12 states that

- every railway administration,
- every port authority and
- every occupier

shall cause to be displayed in a conspicuous and accessible place at every station on its railway or within the limits of a port or at the place of work, as the case may be, a notice in the local language and in the English language containing an abstract of Sections 3A and 14.

## Penalties (Section 14)

1. Whoever employs any child or permits any child to work in contravention of the provisions of section 3 shall be punishable with imprisonment for a term which shall not be less than 6 months but which may extend to 2 years, or with fine which shall not be less than Rs. 20,000 but which may extend to Rs. 50,000, or with both.

   However; the parents or guardians of such children shall not be punished unless they permit such child for commercial purposes in contravention of the provisions of section 3.

1A. Whoever employs any adolescent or permits any adolescent to work in contravention of the provisions of section 3A shall be punishable with imprisonment for a term which shall not be less than 6 months but which may extend to 2 years or with fine which shall not be less than Rs. 20,000 but which may extend to Rs. 50,000 or with both.

   However; the parents or guardians of such adolescent shall not be punished unless they permit such adolescent to work in contravention of the provisions of section 3A.

1B. The parents or guardians of any child or adolescent shall not be liable for punishment, in case of the first offence.

2. Whoever, having been convicted of an offence under section 3 or section 3A commits a like offence afterwards; he shall be punishable with imprisonment for a term which shall not be less than 1 year but which may extend to 3 years.
3. Whoever fails to comply with or contravenes any other provisions of the Act or the rules made thereunder, shall be punishable with simple imprisonment which may extend to 1 month or with fine which may extend to Rs. 10,000 or with both.

## District Magistrate to Implement the Provisions

Section 17A of the Act provides that the appropriate Government may confer such powers and impose such duties on a District Magistrate as may be necessary, to ensure that the provisions of this Act are properly carried out and the District Magistrate may specify the officer, subordinate to him, who shall exercise all or any of the powers, and perform all or any of the duties, so conferred or imposed and the local limits within which such powers or duties shall be carried out by the officer as may be prescribed.

# Chapter 16 : Law of Industrial Relations

## Unit I – Industrial Disputes Act, 1947

The Industrial Disputes Act, 1947 is the legislation for investigation and settlement of all industrial disputes.

## INTRODUCTION

The first enactment dealing with the settlement of industrial disputes was the Employers' and Workmen's Disputes Act, 1860. This Act weighed much against the workers and was therefore replaced by the Trade Disputes Act, 1929. The Act of 1929 contained special provisions regarding strikes in public utility services and general strikes affecting the community as a whole. The main purpose of the Act, however, was to provide a conciliation machinery to bring about peaceful settlement of industrial disputes. The Whitely Commission made in this regard the perceptive observation that the attempt to deal with unrest must begin rather with the creation of an atmosphere unfavourable to disputes than with machinery for their settlement.

The next stage in the development of industrial law in this country was taken under the stress of emergency caused by the Second World War. Rule 81-A of the Defence of India Rules was intended to provide speedy remedies for industrial disputes by referring them compulsorily to conciliation or adjudication, by making the awards legally binding on the parties and by prohibiting strikes or lock-outs during the pendency of conciliation or adjudication proceedings and for two months thereafter. This rule also put a blanket ban on strikes which did not arise out of genuine trade disputes.

With the termination of the Second World War, Rule 81-A was about to lapse on 1st October, 1946, but it was kept alive by issuing an Ordinance in the exercise of the Government's Emergency Powers. Then followed the Industrial Disputes Act, 1947. The provisions of this Act, as amended from time to time, have furnished the basis on which industrial jurisprudence in this country is founded.

## OBJECT AND SIGNIFICANCE OF THE ACT

The Industrial Disputes Act, 1947 makes provision for the investigation and settlement of industrial disputes and for certain other purposes. It ensures progress of industry by bringing about harmony and cordial relationship between the employers and employees. This Act provides with specific guidelines in regards to the work committee for both the businesses and all the workmen to advance measures for good working relations and comprehension among the workmen and the businesses later on, and to end that, it additionally vows to resolve any material difference in views of opinion in regard to such issues. Definitions of the words 'industrial dispute, workmen and industry' carry specific meanings under the Act and provide the framework for the application of the Act.

In the case of Workmen of Dimakuchi Tea Estate v. Dimakuchi Sea Estate, AIR 1958 SC 353, the Supreme Court laid down following objectives of the Act:

a) Promotion of measures of securing and preserving amity and good relations between the employer and workmen.

b) Investigation and settlement of industrial disputes between employers and employers, employers and workmen, or workmen and workmen with a right of representation by registered trade union or federation of trade unions or an association of employers or a federation of associations of employers.

c) Prevention of illegal strikes and lock-outs.

d) Relief to workmen in the matter of lay-off and retrenchment.

e) Promotion of collective bargaining.

This Act extends to whole of India. The Act was designed to provide a self-contained code to compel the parties to resort to industrial arbitration for the resolution of existing or apprehended disputes without prescribing statutory norms for varied and variegated industrial relating norms so that the forums created for resolution of disputes may remain unhampered by any statutory control and devise rational norms keeping pace with improved industrial relations reflecting and imbibing socio-economic justice. This being the object of the Act, the Court by interpretative process must strive to reduce the field of conflict and expand the area of agreement and show its preference for upholding agreements sanctified by mutuality and consensus in larger public interest, namely, to eschew industrial strife, confrontation and consequent wastage [Workmen, Hindustan Lever Limited v. Hindustan Lever Limited, (1984) 1 SCC 728].

The Act applies to an existing and not to a dead industry. It is to ensure fair wages and to prevent disputes so that production might not be adversely affected. It applies to all industries irrespective of religion or caste of parties. It applies to the industries owned by Central and State Governments too [Hospital Employees Union v. Christian Medical College, (1987) 4 SCC 691].

## IMPORTANT DEFINITIONS

### Industry

"Industry" means any business, trade, undertaking, manufacture or calling of employers and includes any calling service, employment, handicraft, or industrial occupation or avocation of workmen. [Section 2(j)]

The Supreme Court carried out an indepth study of the definition of the term industry in a comprehensive manner in the case of Bangalore Water Supply and Sewerage Board v. A Rajiappa, AIR 1978 SC 548 (hereinafter referred to as Bangalore Water Supply case), after considering various previous judicial decisions on the subject and in the process, it rejected some of them, while evolving a new concept of the term "industry".

### Tests for determination of' "industry"

After discussing the definition from various angles, in the above case, the Supreme Court, laid down the following tests to determine whether an activity is covered by the definition of "industry" or not. It is also referred to as the triple test.

1. Where there is

   **a)** systematic activity,

   – organised by co-operation between employer and employee,

- for the production and/or distribution of goods and services calculated to satisfy human wants and wishes (not spiritual or religious but inclusive of material things or services geared to celestial bliss e.g., making, on a large scale, prasad or food) prima facie, there is an "industry" in that enterprise.

**b)** Absence of profit motive or gainful objective is irrelevant wherever the undertaking is whether in the public, joint, private or other sector.

**c)** The true focus is functional and the decisive test is the nature of the activity with special emphasis on the employer-employee relations.

**d)** If the organisation is a trade or business, it does not cease to be one because of philanthrophy animating the undertaking.

**2.** Although Section 2(j) uses words of the widest amplitude in its two limbs, their meaning cannot be magnified to over-stretch itself. Undertaking must suffer a contextual and associational shrinkage, so Law of Industrial Relations also, service, calling and the like. This yields the inference that all organised activity possessing the triple elements in (i) although not trade or business, may still be "industry", provided the nature of the activity, viz., the employer - employee basis, bears resemblance to what we find in trade or business. This takes into the fold of "industry", undertaking, callings and services, adventures analogous to the carrying on of trade or business. All features, other than the methodology of carrying on the activity, viz., in organising the co-operation between employer and employee, may be dissimilar. It does not matter, if on the employment terms, there is analogy.

**3.** Application of these guidelines should not stop short of their logical reach by invocation of creeds, cults or inner sense of incongruity or outer sense of motivation for or resultant of the economic operations. The ideology of the Act being industrial disputes between employer and workmen, the range of this statutory ideology must inform the reach of the statutory definition, nothing less, nothing more.

Hence, the Supreme Court observed that professions, clubs, educational institutions. co-operatives, research institutes, charitable projects and other kindred adventures, if they fulfil the triple tests listed in (1), cannot be exempted from the scope of Section 2(j). A restricted category of professions, clubs, co-operatives and gurukulas and little research labs, may qualify for exemption if, in simple ventures, substantially and going by the dominant nature criterion, substantively, no employees are entertained but in minimal matters, marginal employees are hired without destroying the non-employee character of the unit.

If in a pious or altruistic mission many employ themselves, free or for small honorarium or like return, mainly drawn by sharing in the purpose or cause, such as lawyers volunteering to run a free legal services clinic or doctors serving in their spare hours in a free medical centre or ashramites working at the bidding of the holiness, divinity or like central personality and the services are supplied free or at nominal cost and those who serve are not engaged for remuneration or on the basis of master and servant relationship, then the institution is not an industry even if stray servants, manual or technical, are hired. Such undertakings alone are exempt - not other generosity compassion, developmental compassion or project.

## Criteria for determining dominant nature of undertaking

The Supreme Court, in Bangalore Water Supply case laid down the following guidelines for deciding the dominant nature of an undertaking:

a. Where a complex of activities, some of which qualify for exemption, others not, involves the employees on the total undertaking. Some of whom are not "workmen" or some departments are not productive of goods and services if isolated, nature of the department will be the true test. The whole undertaking will be "industry" although those who are not "workmen" definition may not be benefit by the status.

b. Notwithstanding with previous clause, sovereign functions strictly understood alone qualify for exemption and not the welfare activities or economic adventures undertaken by Government or statutory bodies.

c. Even in departments discharging sovereign functions, if there are units which are industries and they are substantially severable, then they can be considered to come within Section 2(j).

d. Constitutional and competently enacted legislative provisions may well remove an undertaking from the scope of the Act.

The above decision of the Supreme Court has a wide sweep. The triple test along with dominant nature criteria will cover almost the entire labour force in the country. The charitable or missionary institutions, hospital, educational and other research institutions, municipal corporations, firms of chartered accountants, solicitors' firms, etc., which were not held to be "industry" earlier will now are covered by the definition of "industry".

## Industrial Dispute

"Industrial Dispute" means any dispute or difference between employers and employers, or between employers and workmen, or between workmen and workmen, which is connected with the employment or non-employment or the terms of employment or with the conditions of labour, of any person. [Section 2(k)]

The above definition can be analysed and discussed under the following heads:

i. There should exist a dispute or difference;

ii. The dispute or difference should be between:

   **a**. employer and employer;

   **b**. employer and workmen; or

   **c**. workmen and workmen.

iii. The dispute or difference should be connected with (a) the employment or non-employment, or (b) terms of employment, or (c) the conditions of labour of any person;

iv. The dispute should relate to an industry as defined in Section 2(j).

Industrial dispute implies any distinction of conclusion, contest, injury between the business and the representatives, or between the laborers and bosses, or between the labourers or workers itself which is all concerned with the work or non-business terms or terms of business dependent on the terms of state of work of any person.

## Workman

"Workman" means any person (including an apprentice) employed in any industry to do any manual, unskilled, skilled, technical, operational, clerical or supervisory work for hire or reward, whether the terms of employment be expressed or implied and for the purposes of any proceeding under this Act in relation to an industrial dispute, includes:

a. any such person who has been dismissed, discharged or retrenched in connection with, or as a consequence of that dispute; or

b. any person whose dismissal, discharge or retrenchment has led to that dispute, but does not include any such person:

   1. who is subject to the Army Act, 1950, or the Air Force Act, 1950 or the Navy Act, 1957; or
   2. who is employed in the police service or as an officer or other employee of a prison; or
   3. who is employed mainly in a managerial or administrative capacity; or
   4. who is employed in a supervisory capacity drawing more than Rs. 1,600 per month as wages; or
   5. who is exercising either by the nature of the duties attached to the office or by reason of the powers vested in him, functions mainly of a managerial nature. [Section 2(s)]

## Strike

"Strike" means a cessation of work by a body of persons employed in any industry acting in combination, or a concerted refusal, or a refusal under a common understanding of any number of persons who are or have been so employed to continue to work or to accept employment. [Section 2(q)]

Strike is a weapon of collective bargaining in the armount of workers. The following points may be noted regarding the definition of strike:

- Strike can take place only when there is a cessation of work or refusal to work by the workmen acting in combination or in a concerted manner. Time factor or duration of the strike is immaterial. The purpose behind the cessation of work is irrelevant in determining whether there is a strike or not. It is enough if the cessation of work is in defiance of the employers authority.

  Proof of formal consultations is not required. However, mere presence in the striking crowd would not amount to strike unless it can be shown that there was cessation of work.

- A concerted refusal or a refusal under a common understanding of any number of persons to continue to work or to accept employment will amount to a strike. A general strike is one when there is a concert of combination of workers stopping or refusing to resume work. Going on mass casual leave under a common understanding amounts to a strike. However, the refusal by workmen should be in respect of normal lawful work which the workmen are under an obligation to do. But refusal to do work which the employer has no right to ask for performance, such a refusal does not constitute a strike

(Northbrooke Jute Co. Ltd. v. Their Workmen, AIR 1960 SC 879). If on the sudden death of a fellow-worker, the workmen acting in concert refuse to resume work, it amounts to a strike [National Textile Workers' Union v. Shree Meenakshi Mills, (1951) II L.L.J. 516].

- The striking workman, must be employed in an "industry" which has not been closed down.
- Even when workmen cease to work, the relationship of employer and employee is deemed to continue albeit in a state of belligerent suspension. In Express Newspaper (P.) Ltd. v. Michael Mark, 1962-11, L.L.J. 220 S.C., the Supreme Court observed that if there is a strike by workmen, it does not indicate, even when strike is illegal, that they have abandoned their employment. However, for illegal strike, the employer can take disciplinary action and dismiss the striking workmen.

## TYPES OF STRIKE AND THEIR LEGALITY

**a) Stay-in, sit-down, pen-down or tool-down strike**

In all such cases, the workmen after taking their seats, refuse to do work. Even when asked to leave the premises, they refuse to do so. All such acts on the part of the workmen acting in combination, amount to a strike. Since such strikes are directed against the employer, they are also called primary strikes. In the case of Punjab National Bank Ltd. v. All India Punjab National Bank Employees' Federation, AIR 1960 SC 160, the Supreme Court observed that on a plain and grammatical construction of this definition it would be difficult to exclude a strike where workmen enter the premises of their employment and refuse to take their tools in hand and start their usual work. Refusal under common understanding not to work is a strike. If in pursuance of such common understanding the employees enter the premises of the Bank and refuse to take their pens in their hands that would no doubt be a strike under Section 2(q).

**b) Go-slow**

Go-slow does not amount to strike, but it is a serious case of misconduct.

In the case of Bharat Sugar Mills Ltd. v. Jai Singh, (1961) II LU 644 (647) SC, the Supreme Court explained the legality of go-slow in the following words: "Go-slow which is a picturesque description of deliberate delaying of production by workmen pretending to be engaged in the factory, is one of the most pernicious practices that discontented and disgruntled workmen sometimes resort to. Thus, while delaying production and thereby reducing the output, the workmen claim to have remained employed and entitled to full wages. Apart from this, 'go-slow' is likely to be much more harmful than total cessation of work by strike. During a go-slow much of the machinery is kept going on at a reduced speed which is often extremely damaging to the machinery parts. For all these reasons, 'go- slow' has always been considered a serious type of misconduct."

In another case, it was observed that slow-down is an insidious method of undermining the stability of a concern and Tribunals certainly will not countenance it. It was held that 'go slow' is a serious misconduct being a covert and a more damaging breach of the contract of employment (SU Motors v. Workman 1990-11 LU 39). It is not a legitimate weapon in the armory of labour. It has been regarded as a misconduct.

**c) Sympathetic strike**

Cessation of work in the support of the demands of workmen belonging to other employer is called a sympathetic strike. This is an unjustifiable invasion of the right of employer who is not at all involved in the dispute. The management can take disciplinary action for the absence of workmen. However, in Ramalingam v. Indian Metallurgical Corporation, Madras, 1964-1 L.L.J. 81, it was held that such cessation of work will not amount to a strike since there is no intention to use the strike against the management.

**d) Hunger strike**

Some workers may resort to fast on or near the place of work or residence of the employer. If it is peaceful and does not result in cessation of work, it will not constitute a strike. But if due to such an act, even those present for work, could not be given work, it will amount to strike [Pepariach Sugar Mills Ltd. v. Their Workmen).

**e) Work-to-rule**

Since there is no cessation of work, it does not constitute a strike.

## LEGALITY OF STRIKE

The legality of strike is determined with reference to the legal provisions enumerated in the Act and the purpose for which the strike was declared is not relevant in directing the legality. Section 10(3), 10A(4A), 22 and 23 of the Act deals with strike. Sections 22 and 23 impose restrictions on the commencement of strike while Sections 10(3) and 10A(4A) prohibit its continuance.

The justifiability of strike has no direct relation to the question of its legality and illegality. The justification of strike as held by the Punjab & Haryana High Court in the case of Matchwell Electricals of India v. Chief Commissioner, (1962) 2 LU 289, is entirely unrelated to its legality or illegality. The justification of strikes has to be viewed from the stand point of fairness and reasonableness of demands made by workmen and not merely from stand point of their exhausting all other legitimate means open to them for getting their demands fulfilled.

The Supreme Court in Gujarat Steel Tubes Ltd. v. Gujarat Steel Tubes Majdoor Sabha, AIR 1980 SC 1896 held that justifiability of a strike is purely a question of fact. Therefore, if the strike was resorted to by the workers in support of their reasonable, fair and bona fide demands in peaceful manner, then the strike will be justified.

Where it was resorted to by using violence or acts of sabotage or for any ulterior purpose, then the strike will be unjustified.

As regards the wages to the workers strike period are concerned, the Supreme Court in Charakulam Tea Estate v. Their Workmen, AIR 1969 SC 998 held that in case of strike which is legal and justified, the workmen will be entitled to full wages for the strike period. Similar view was taken by the Supreme Court in Crompton Greaves Ltd. case 1978 Lab 1C 1379 (SC).

The Supreme Court in Statesman Ltd. v. Their Workman, AIR 1976 SC 758 held that if the strike is illegal or unjustified, strikers will not be entitled to the wages for the strike period unless considerate circumstances constraint a different cause. Similar view was taken by the

Supreme Court in Madura Coats Ltd. v. The Inspector of Factories, Madurai, AIR 1981 SC 340.

The Supreme Court has also considered the situation if the strike is followed by lockout and vice versa, and both are unjustified, in India Marine Service Pvt. Ltd. v. Their Workman, AIR 1963 SC 528. In this case, the Court evolved the doctrine of "apportionment of blame" to solve the problem. According to this doctrine, when the workmen and the management are equally to be blamed, the Court normally awards half of the wages. This doctrine was followed by the Supreme Court in several cases. Thus, the examination of the above cases reveal that when the blame for situation is apportioned roughly half and half between the management and workmen, the workmen are given half of the wages for the period involved.

A division bench of the Supreme Court in the case of Bank of India v. TS Kelawala, (1990) 2 Lab 1C 39 held that the workers are not entitled to wages for the strike period. The Court observed that "the legality of strike does not always exempt the employees from the deduction of their salaries for the period of strike". The Court, further observed, "whether the strike is legal or illegal, the workers are liable to lose wages does not either make the strike illegal as a weapon or deprive the workers of it".

## Lock-out

"Lock-out" means the temporary closing of a place of employment, or the suspension of work, or the refusal by an employer to continue to employ any number of persons employed by him. [Section 2(I)]

Lock out is an antithesis to strike. Just as "strike" is a weapon available to the employees for enforcing their industrial demands, a "lock out" is a weapon available to the employer to persuade by a coercive process the employees to see his point of view and to accept his demands [Express Newspapers (P). Ltd. v. their Workers (1962) II L.L.J. 227 SC].

In lock out, the employer refuses to continue to employ the workman employed by him even though there is no intention to close down the unit. The essence of lock out is the refusal of the employer to continue to employ workman. Even if suspension of work is ordered, it would constitute lock out. But mere suspension of work, unless it is accompanied by an intention on the part of employer as a retaliation, will not amount to lock out.

Locking out workmen does not contemplate severance of the relationship of employer and the workmen. In the case Lord Krishna Sugar Mills Ltd. v. State of U.P., (1964) II LU 76 (AII), a closure of a place of business for a short duration of 30 days in retaliation to certain acts of workmen (i.e. to teach them a lesson) was held to be a lock out. But closure is not a lock out.

## Lay-off

"Lay-off' (with its grammatical variations and cognate expressions) means the failure, refusal or inability of an employer to give employment due to following reasons, to a workman whose name appears on the muster-rolls of his industrial establishment and who has not been retrenched:

**a.** shortage of coal, power or raw materials, or

**b.** accumulation of stocks, or

**c.** break-down of machinery, or

**d.** natural calamity, or

**e.** for any other connected reason. [Section 2(kkk)]

**Explanation:** Every workman whose name is borne on the muster rolls of the industrial establishment and who presents himself for work at the establishment at the time appointed for the purpose during normal working hours on any day and is not given employment by the employer within two hours of his so presenting himself shall be deemed to have been laid-off for that day within the meaning of this clause.

Provided that if the workman, instead of being given employment at the commencement of any shift for any day is asked to present himself for the purpose during this second half of the shift for the day and is given employment, then, he shall be deemed to have been laid-off only for one-half of that day.

Provided further that if he is not given any such employment even after so presenting himself, he shall not be deemed to have been laid-off for the second half of the shift for the day and shall be entitled to full basic wages and dearness allowance for that part of the day.

From the above provisions, it is clear that lay-off is a temporary stoppage and within a reasonable period of time, the employer expects that his business would continue and his employees who have been laid-off, the contract of employment is not broken but is suspended for the time being. But in the case of M.A. Veirya v. C.P. Fernandez, 1956-1, L.L.J. 547 Bomb., it was observed that it is not open to the employer, under the cloak of "lay-off", to keep his employees in a state of suspended animation and not to make up his mind whether the industry or business would ultimately continue or there would be a permanent stoppage and thereby deprive his employees of full wages. In other words, the lay-off should not be mala fide in which case it will not be layoff. Tribunal can adjudicate upon it and find out whether the employer has deliberately and maliciously brought about a situation where lay-off becomes necessary. But, apart from the question of mala fide, the Tribunal cannot sit in judgement over the acts of management and investigate whether a more prudent management could have avoided the situation which led to lay-off [Tatanagar Foundry v. Their Workmen, AIR 1962 SC 1533].

Further, refusal or inability to give employment must be due to

a) shortage of coal, power or raw materials, or
b) accumulation of stock, or
c) break-down of machinery,
d) natural calamity, or
e) for any other connected reason. Financial stringency cannot constitute a ground for lay-off (Hope Textiles Ltd. v. State of MP, 1993 I LU 603).

Lastly, the right to lay-off cannot be claimed as an inherent right of the employer. This right must be specifically provided for either by the contract of employment or by the statute (Workmen of Dewan Tea Estate v. Their Management). In fact 'lay-off' is an obligation on the part of the employer, i.e., in case of temporary stoppage of work, not to discharge the workmen but to lay-off the workmen till the situation improves. Power to lay-off must be

found out from the terms of contract of service or the standing orders governing the establishment (Workmen v. Firestone Tyre and Rubber Co., 1976 3 SCC 819).

There cannot be lay-off in an industrial undertaking which has been closed down. Lay-off and closure cannot stand together.

## Difference between lay-off and lock-out

1. In lay-off, the employer refuses to give employment due to certain specified reasons, but in lock-out, there is deliberate closure of the business and employer locks out the workers not due to any such reasons.
2. In lay-off, the business continues, but in lock-out, the place of business is closed down for the time being.
3. In a lock-out, there is no question of any wages or compensation being paid unless the lock-out is held to be unjustified.
4. Lay-off is the result of trade reasons but lock-out is a weapon of collective bargaining.
5. Lock-out is subject to certain restrictions and penalties but it is not so in case of lay-off.

However, both are of temporary nature and in both cases the contract of employment is not terminated but remains in suspended animation.

## Retrenchment

"Retrenchment" means the termination by the employer of the service of a workman for any reason whatsoever, otherwise than as a punishment inflicted by way of disciplinary action, but does not include:

a. voluntary retirement of the workman; or

b. retirement of the workman or reaching the age of superannuation if the contract of employment between the employer and the workman concerned contains a stipulation in that behalf; or

   termination of the service of the workman as a result of the non-renewal of the contract of employment between the employer and the workman concerned on its expiry or of such contract being terminated under a stipulation in that behalf contained therein.

c. termination of the service of workman on the ground of continued ill-health.

Thus, the definition contemplates following requirements for retrenchment:

1. There should be termination of the service of the workman.
2. The termination should be by the employer.
3. The termination is not the result of punishment inflicted by way of disciplinary action.
4. The definition excludes termination of service on the specified grounds or instances mentioned in it. [Section 2(oo)]

## Award

"Award" means an interim or a final determination of any industrial dispute or of any question relating thereto by any Labour Court, Industrial Tribunal or National Industrial Tribunal and includes an arbitration award made under Section 10-A. [Section 2(b)]

This definition was analysed in the case of Cox & Kings (Agents) Ltd. v. Their Workmen, AIR 1977 S.C. 1666 as follows: The definition of "award" is in two parts. The first part covers a determination, final or interim, of any industrial dispute. The second part takes in a determination of any question relating to an industrial dispute. However, basic thing to both the parts is the existence of an industrial dispute, actual or apprehended. The 'determination contemplated is of the industrial dispute or a question relating thereto on merits.

## Appropriate Government

"Appropriate Government" means:

1. in relation to any industrial disputes concerning any industry carried on by or under the authority of the Central Government or by a railway company or concerning any such controlled industry as may be specified in this behalf by the Central Government or in relation to:
   - an industrial dispute concerning a Dock Labour Board established under Section 5-A of the Dock Workers (Regulation of Employment) Act, 1948 or
   - the Industrial Finance Corporation of India Limited formed and registered under the Companies Act, 1956, or
   - the Employees' State Insurance Corporation established under Section 3 of the Employees' State Insurance Act, 1948 or
   - the Board of Trustees constituted under Section 3-A of the Coal Mines Provident Fund and Miscellaneous Provisions Act, 1948 or
   - the Central Board of Trustees and the State Boards of Trustees constituted under Section 5-A and Section 5-B, respectively, of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 or
   - the Life Insurance Corporation of India established under Section 3 of the Life Insurance Corporation Act, 1956 or
   - the Oil and Natural Gas Corporation Limited registered under the Companies Act, 1956, or
   - the Deposit Insurance and Credit Guarantee Corporation established under Section 3 of the Deposit Insurance and Credit Guarantee Corporation Act, 1961, or
   - the Central Warehousing Corporation established under Section 3 of the Warehousing Corporation Act, 1962, or
   - the Unit Trust of India established under Section 3 of the Unit Trust of India Act, 1963, or
   - the Food Corporation of India established under Section 3, or
   - a Board of Management established for two or more contiguous States under Section 16 of the Food Corporations Act, 1964, or
   - the Airports Authority of India constituted under Section 3 of the Airports Authority of India Act, 1994, or
   - a Regional Rural Bank established under Section 3 of the Regional Rural Banks Act, 1976 or

- the Export Credit and Guarantee Corporation Limited or the Industrial Reconstruction Corporation of India Limited, the National Housing Bank establishment under Section 3 of the National Housing Bank Act, 1987 or
- the Banking Service Commission established under Section 3 of the Banking Service Commission Act, 1975, or
- an air transport service, or a banking or an insurance company, a mine, an oil-field, a Cantonment Board or a major port, the Central Government, and

**2.** in relation to any other Industrial Dispute, the State Government. [Section 2(a)]

## Average Pay

"Average pay" means the average of the wages payable to a workman:

a) in the case of monthly paid workman, in the three complete calendar months;

b) in the case of weekly paid workman, in the four complete weeks;

c) in the case of daily paid workman, in the twelve full working days preceding the date on which the average pay becomes payable if the workman had worked for three complete calendar months or four complete weeks or twelve full working days as the case may be, and where such calculation cannot be made, the average pay shall be calculated as the average of the wages payable to a workman during the period he actually worked. [Section 2(aaa)]

## Closure

"Closure" means the permanent closing down of a place of employment or a part thereof. [Section 2(cc)]

## Controlled Industry

"Controlled Industry" means any industry the control of which by the Union has been declared by any Central Act to be expedient in the public interest. [Section 2(ee)]

## Employer

"Employer" means:

- in relation to an industry carried on by or under the authority of any department of the Central Government or a State Government, the authority prescribed in this behalf, or where no authority is prescribed, the head of the department;
- in relation to an industry carried on by or on behalf of a local authority, the chief executive officer of that authority. [Section 2(g)]

"Employer includes among others an agent of an employer, general manager, director, occupier of factory etc.

## Public Utility Service

"Public Utility Service" means:

a) any railway service or any transport service for the carriage of passengers or goods by air;

ia) any service in, or in connection with the working of, any major port or dock;

b) any section of an industrial establishment, on the working of which the safety of the establishment or the workman employed therein depends;

c) any postal, telegraph or telephone service;

d) any industry which supplies power, light or water to the public;

e) any system of public conservancy or sanitation;

f) any industry specified in the First Schedule which the appropriate Government may, if satisfied that public emergency or public interest so requires, by notification in the Official Gazette, declare to be a public utility service for the purposes of this Act, for such period as may be specified in the notification:

Provided that the period so specified shall not, in the first instance, exceed six months but may, by a like notification, be extended from time to time, by any period not exceeding six months at any one time, if in the opinion of the appropriate Government public emergency or public interest requires such extension. [Section 2(n)]

Public utility services may be carried out by private companies or business corporations [D.N. Banerji v. P.R. Mukharjee (Budge Budge Municipality), AIR 1953 SC 58].

## Settlement

"Settlement" means a settlement arrived at in the course of conciliation proceeding and includes a written agreement between the employer and workmen arrived at otherwise than in the course of conciliation proceeding where such agreement has been signed by the parties thereto in such manner as may be prescribed and a copy thereof has been sent to an officer authorised in this behalf by the appropriate Government and the conciliation officer. [Section 2(p)]

## Trade Union

"Trade Union" means a trade union registered under the Trade Unions Act, 1926. [Section 2(qq)]

## Unfair Labour Practice

It means any of the practices specified in the Fifth Schedule. [Section 2(ra)]

## Wages

"Wages" means all remuneration capable of being expressed in terms of money, which would, if the terms of employment, expressed or implied, were fulfilled, be payable to workman in respect of his employment or of work done in such employment, and includes:

i. such allowance (including dearness allowance) as the workman is for the time being entitled to;

ii. the value of any house accommodation, or of supply of light, water, medical attendance or other amenity or of any service or of any concessional supply of foodgrains or other articles;

iii. any travelling concession,

but does not include:

a. any bonus;

b. any contribution paid or payable by the employer to any pension fund or provident fund or for the benefit of the workman under any law for the time being in force;

c. any gratuity payable on the termination of his service;

d. any commission payable on the promotion of sales or business or both. [Section 2(rr)]

## AUTHORITIES UNDER THE ACT AND THEIR DUTIES

The Act provides for following Authorities for Investigation and settlement of industrial disputes:

a) Works Committee.

b) Conciliation Officers.

c) Boards of Conciliation.

d) Court of Inquiry.

e) Labour Tribunals.

f) Industrial Tribunals.

g) National Tribunal.

### i. Works Committee

Section 3 of the Act provides that the appropriate Government may by general or special order require the employer to constitute in the prescribed manner a Works Committee in industrial establishments, where 100 or more workmen are employed or have been employed on any working day in the preceding 12 months. The Works Committee will be comprised of the representatives of employers and workmen engaged in the establishment.

It shall be the duty of the Works Committee to promote measures for securing and preserving amity and good relations between the employer and workmen and, to that end, to comment upon matters of their common interest or concern and endeavour to compose any material difference of opinion in respect of such matters [Section 3(2)].

### ii. Conciliation Officers

With the duty of mediating in and promoting the settlement of industrial disputes, the appropriate Government may, by notification in the Official Gazette, appoint such number of Conciliation Officers as it thinks fit. The Conciliation Officer may be appointed for a specified area or for specified industries in a specified area or for one or more specified industries and either permanently or for a limited period. The main objective of appointing the Conciliation Officers, by the appropriate Government, is to create congenial atmosphere within the establishment where workers and employers can reconcile on their disputes through the mediation of the Conciliation Officers. Thus, they help in promoting the settlement of the disputes. (Section 4)

### iii. Boards of Conciliation

For promoting the settlement of an industrial dispute, the appropriate Government may, as occasion arises, constitute by a notification in the Official Gazette, a Board of Conciliation. A Board shall consist of a Chairman and two or four other members as the appropriate Government thinks fit.

It shall be the duty of Board to endeavour to bring about a settlement of the dispute and for such purpose it shall, without delay, investigate into the dispute and all matters affecting the merits and the right settlement. The Board may also do all such things which may be considered fit by it, for including the parties to come for a fair and amicable settlement of the dispute. In case of settlement of the dispute, the Board shall send a report thereof to the appropriate Government together with a memorandum of settlement signed by all the parties to the dispute. In case no settlement is arrived at, the Board shall forward a report to appropriate Government enlisting therein the steps taken by the Board for ascertaining the facts and circumstances related to the dispute and for bringing about a settlement thereof. The Board will also enlist the reasons on account of which in its opinion a settlement could not be arrived at and its recommendations for determining the disputes. (Section 5)

### iv. Courts of inquiry

According to Section 6 of the Act, the appropriate Government may as occasion arises, by notification in the Official Gazette constitute a Court of Inquiry into any matter appearing to be connected with or relevant to an industrial dispute. A Court may consist of one independent person or of such number of independent persons as the appropriate Government may think fit and where a Court consists of two or more members, one of them shall be appointed as the Chairman. It is the duty of such a Court to inquire into matters referred to it and submit its report to the appropriate Government ordinarily within a period of six months from the commencement of the inquiry. The period within which the report is to be submitted is not mandatory and the report may be submitted even beyond the period of six months without affecting the legality of the inquiry.

### v. Labour Courts

Under Section 7, the appropriate Government is empowered to constitute one or more Labour Courts for adjudication of industrial disputes relating to any matter specified in the Second Schedule and for performing such other functions as may be assigned to them under the Act.

A Labour Court shall consist of one person only to be appointed by the appropriate Government. A person shall not be qualified for appointment as the presiding officer of a Labour Court unless —

a. he is, or has been, a judge of a High Court: or
b. he has, for a period not less than three years, been a district Judge or an Additional District Judge; or
c. he has held any judicial office in India for not less than seven years; or

d. he has been the presiding officer of a Labour Court constituted under any provincial Act or State Act for not less than five years.

When an industrial dispute has been referred to a Labour Court for adjudication, it is the duty of the Labour Court to (i) hold its proceedings expeditiously, and (ii) submit its award to the appropriate Government soon after the conclusion of the proceedings. No time period has been laid down for the completion of proceedings but it is expected that such Courts will hold their proceedings without going into the technicalities of a Civil Court. Labour Court has no power to permit suo motu the management to avail the opportunity of adducing fresh evidence in support of charges (1998 Lab 1C 540 AP).

Provisions of Article 137 of the Limitation Act do not apply to reference of dispute to the Labour Court. In case of delays, Court can mould relief by refusing back wages or directing payment of past wages (1999 LAB 1C SC 1435).

**vi. Industrial Tribunals**

1. The appropriate Government may by notification in the Official Gazette, constitute one or more Industrial Tribunals for the adjudication of industrial disputes relating to any matter whether specified in the Second Schedule or the Third Schedule and for performing such other functions as may be assigned to them under this Act.
2. A Tribunal shall consist of one person only to be appointed by the appropriate Government.
3. A person shall not be qualified for appointment as the presiding officer of a Tribunal unless:
   a. he is, or has been, a Judge of High Court; or
   b. he has, for a period of not less than three years, been a District Judges or an Additional District Judge.
4. The appropriate Government may, if it so thinks fit, appoint two persons as assessors to advise the Tribunal in the proceedings before it.

Further, the person appointed as a Presiding Officer should be an independent person and must not have attained the age of 65 years. (Section 7-A)

The Industrial Tribunal gets its jurisdiction on a reference by the appropriate Government under Section 10. The Government can nominate a person to constitute a Tribunal for adjudication of industrial disputes as and when they arise and refer them to it. The Tribunal may be constituted for any limited or for a particular case or area. If appointed for a limited period, it ceases to function after the expiry of the term even when some matters are still pending (J.B. Mangharam & Co. v. Kher, A.I.R. 1956 M.B.113).

**vii. National Tribunals**

1. Under Section 7-B, the Central Government alone has been empowered to constitute one or more National Tribunals for the adjudication of industrial disputes which

   a) involve questions of national importance or

b) are of such a nature that industrial establishments situated in more than one State are likely to be interested in or affected by such disputes;

2. A National Tribunal shall consist of one person only to be appointed by the Central Government;
3. A person shall not be qualified for appointment as the Presiding Officer of a National Tribunal unless: he is, or has been, a Judge of a High Court; or
4. The Central Government may, if it so thinks fit, appoint two persons as assessors to advise the National Tribunal in the proceeding before it.

Section 7-C further provides that such a presiding officer should be an independent person and must not have attained the age of 65 years.

## REFERENCE OF DISPUTES

The adjudication of industrial disputes by Conciliation Board, Labour Court, Court of Inquiry, Industrial Tribunal or National Tribunal can take place when a reference to this effect has been made by the appropriate Government under Section 10. The various provisions contained in this lengthy Section are summed up below:

**A. Reference of disputes to various Authorities**

Where the appropriate Government is of the opinion that any industrial dispute exists or is apprehended, it may at any time, by order in writing make a reference to various authorities in the following ways:

**a.** It may refer the dispute to a Conciliation Board for promoting the settlement of the dispute. As noted earlier, duty of the Board is to promote settlement and not to adjudicate the dispute. A failure report of the Board will help the Government to make up its mind as to whether the dispute can be referred for compulsory adjudication. Further, any matter appearing to be connected with or relevant to the dispute cannot be referred to a Conciliation Board (Nirma Textile Finishing Mills Ltd. v. Second Tribunal, Punjab 1957 I L.L.J. 460 S.C.).

**b.** It may refer any matter appearing to be connected with or relevant to the dispute to a Court of Inquiry. The purpose of making such a reference is not conciliatory or adjudicatory but only investigatory.

**c.** It may refer the dispute, or any matter appearing to be connected with, or relevant to, the dispute if it relates to any matter specified in the Second Schedule, to a Labour Court for adjudication. However, disputes relating to any matter falling in the Third Schedule can also be referred to a Labour Court, if the appropriate Government so thinks fit provided the dispute is not likely to affect more than 100 workmen.

**d.** It may refer the dispute or any matter appearing to be connected with, or relevant to the dispute specified in the Second or Third Schedule, to an Industrial Tribunal for adjudication. [Section 10(1)]

Under the second proviso to Section 10(1), where the dispute relates to a public utility service and a notice of strike or lock-out under Section 22 has been given, it is mandatory for the appropriate Government or the Central Government as the case may

be, to make a reference even when some proceedings under the Act are pending in respect of the dispute. But the Government may refuse to make the reference if it considers that:

i. notice of strike/lock-out has been frivolously or vexatiously given, or

ii. it would be inexpedient to make the reference.

If the Government comes to a conclusion and forms an opinion which is vitiated by mala fide or biased or irrelevant or extraneous considerations, then the decision of the Government will be open to judicial review.

Where the parties to an industrial dispute apply in the prescribed manner, whether jointly or separately, for a reference of the dispute to a Board, Court (Labour Court, Tribunal or National Tribunal), the appropriate Government, if satisfied that the person applying represent the majority of each party, shall make the reference accordingly.

The Industrial Disputes Act provides for no appeal or revision as against the awards so made nor any such remedy is specifically provided for by any other statute or statutory provision though no doubt the Supreme Court in its discretion may under Article 136 of the Constitution of India, grant special leave to a party aggrieved by such an award to appeal to the Supreme Court against an award so made (1978-11 Labour Law Journal, Cal.).

Section 10(1) providing for the powers of appropriate Government to make a reference, has been the favoured subject of judicial interpretation. The various observations made in the course of judicial interpretation of Section 10(1) are summarised below:

a) The order making a reference is an administrative act and it is not a judicial or quasi-judicial act [State of Madras v. C.P. Sarathy, (1953) I L.L.J. 174 SC]. It is because the Government cannot go into the merits of the dispute. Its duty is only to refer the dispute for the adjudication of the authority so that the dispute is settled at an early date.

b) The powers of the appropriate Government to make a reference is discretionary but within narrow limits it is open to judicial review.

c) Ordinarily the Government cannot be compelled to make a reference. But in such a situation the Government must give reasons under Section 12(5) of the Act. If the Court is satisfied that the reasons given by the Government for refusing to the issue, the Government can be compelled to reconsider its decision by a writ of Mandamus (State of Bombay v. K.P. Krishnan, AIR 1960 SC 1223). The appropriate government is not bound to refer belated claims (1994 I LLN 538 P&H DB).

d) In the case of Western India Match Co. Ltd. v. Workmen, it was held that it is not mandatory for the appropriate Government to wait for the outcome of the conciliation proceedings before making an order of reference. The expression "the appropriate Government at any time may refer" takes effect in such cases where the Government decides to make a reference without waiting for concilliation proceedings to begin or to be completed.

e) Refusal of the Government to refer the dispute for adjudication does not debar it from making subsequent reference. It at one stage the appropriate Government had come to the conclusion that no reference was called for in the interest of industrial peace, there is nothing in the Act, which bars it from reexamining the matter, whether in the light of fresh material or otherwise, and from making a reference if it comes to the conclusion that a reference is justified and it is expedient in the interest of industrial peace to make such reference (Western India Match Co. Ltd. v. Workers Union).

f) The appropriate Government has no power either expressly or impliedly to cancel, withdraw or supersede any matter referred for adjudication. However, it is empowered to add to or amplify a matter already referred for adjudication (State of Bihar v. D.N. Ganguli, 1958-11 L.L.J. 634 S.C.). The Government is competent to correct clerical error (Dabur Ltd. v. Workmen, AIR 1968 S.C. 17). Even the Government can refer a dispute already pending before a Tribunal, afresh to another Tribunal, if the former Tribunal has ceased to exist. Now under Section 33-B the Government is empowered to transfer any dispute from one Tribunal to another Tribunal.

g) If reference to dispute is made in general terms and disputes are not particularised, the reference will not become bad provided the dispute in question can be gathered by Tribunal from reference and surrounding facts (State of Madras v. C.P. Sarthy. Also see Hotel Imperial, New Delhi v. The Chief Commissioner, Delhi).

h) The appropriate Government can decide, before making a reference, the prima facie case, but it cannot decide the issue on merits [Bombay Union of Journalists v. State of Bombay, (1964) 1 L.L.J., 351 SC].

**B. Reference of dispute to National Tribunal involving question of importance, etc.**

According to Section 10(1-A), where the Central Government is of opinion that any industrial dispute exists or is apprehended and the dispute involves any question of national importance or is of such a nature that industrial establishments situated in more than one State are likely to be interested in, or affected by such dispute and that the dispute should be adjudicated by a National Tribunal, then, the Central Government may, whether or not it is the appropriate Government in relation to that dispute, at any time, by order in writing, refer the dispute or any matter appearing to be connected with, or relevant to the dispute, whether it relates to any matter specified in the Second Schedule or the Third Schedule, to a National Tribunal, and accordingly.

**a.** If the matter under adjudication before the National Tribunal is pending in a proceeding before a Labour Court or Tribunal, the proceeding before the Labour Court or the Tribunal, as the case may be in so far as it relates to such matter, shall be deemed to have been quashed on such reference to the National Tribunal; and

**b.** It shall not be lawful for the appropriate Government to refer the matter under adjudication before the National Tribunal to any Labour Court or Tribunal for

adjudication during the pendency of the proceeding in relation to such matter before the National Tribunal. [Section 10(1-A) and 10(5)]

In this sub-section, "Labour Court" or "Tribunal" includes any Court or other authority constituted under any law relating to investigation and settlement of industrial disputes in force in any State.

**C. Reference on application of parties**

According to Section 10(2), where the parties to an industrial disputes apply in the prescribed manner, whether jointly or separately, for a reference of the dispute to a Board, Court, Labour Court, Tribunal or National Tribunal, the appropriate Government, if satisfied that the persons applying represent the majority of each party, shall make the reference accordingly and shall specify the time limit (not exceeding three months) to submit the award, such time limit may be extended if required.

Thus, it is mandatory for the Government to make a reference if

i. application to this effect has been made by the parties to the dispute, and

ii. the applicants represent the majority of each party to the satisfaction of the appropriate Government.[Poona Labour Union v. State of Maharashtra, (1969) II L.L.J. 291 Bombay]. The Government cannot, before making reference, go into the question of whether any industrial dispute exists or is apprehended.

**D. Time limit for submission of awards**

According to Section 10(2A) an order referring an industrial dispute to a Labour Court, Tribunal or National Tribunal shall specify the period within which its award shall be submitted to the appropriate Government. The idea is to expedite the proceedings. Sub-section (2A) reads as follows:

"An order referring an industrial dispute to a Labour Court, Tribunal or National Tribunal under this Section shall specify the period within which such Labour Court, Tribunal or National Tribunal shall submit its award on such dispute to the appropriate Government.

Provided that where such dispute is connected with an individual workman, no such period shall exceed three months:

Provided further that where the parties to an industrial dispute apply in the prescribed manner, whether jointly or separately, to the Labour Court, Tribunal or National Tribunal for extension of such period or for any other reason, and the presiding officer of such Labour Court, Tribunal or National Tribunal considers it necessary or expedient to extend such period, he may for reasons to be recorded in writing, extend such period by such further period as he may think fit:

Provided also that in computing any period specified in this sub-section, the period, if any, for which the proceedings before the Labour Court, Tribunal or National Tribunal had been stayed by any injunction or order of a Civil Court shall be excluded:

Provided also that no proceedings before a Labour Court, Tribunal or National Tribunal shall lapse merely on the ground that any period specified under this sub-section had expired without such proceedings being completed".

**E. Prohibition of strike or lock-out**

Where an industrial dispute has been referred to a Board, Labour Court, Tribunal or National Tribunal under this Section, the appropriate Government may by order prohibit the continuance of any strike or lock-out in connection with such dispute which may be in existence on the date of the reference. [Section 10(3)]

It is necessary that the Government makes an order prohibiting strike or lock out. If no order is made, continuance of strike or lock-out is not illegal. Further, once the order prohibiting strike or lock-out is made, the mere fact that strike was on a matter not covered by the reference, is immaterial [Keventers Karamchari Sangh v. Lt. Governor Delhi, (1971) II L.L.J. 525 Delhi].

The only requirement for taking action under Section 10(1) is that there must be some material before the Government which will enable the appropriate Government to form an opinion that an industrial dispute exists or is apprehended. This is an administrative function of the Government as the expression is understood in contradiction to judicial or quasi-judicial function. Merely because the Government rejects a request for a reference or declines to make a reference, it cannot be said that the industrial dispute has ceased to exist, nor could it be said to be a review of any judicial or quasi-judicial order or determination. The industrial dispute may nevertheless continue to remain in existence and if at a subsequent stage the appropriate Government is satisfied that in the interest of industrial peace and for promoting industrial harmony it is desirable to make a reference, the appropriate Government does not lack power to do so under Section 10(1) nor is it precluded from making a reference on the only ground that on an earlier occasion, it had declined to make the reference.

**F. Subject-matter of adjudication**

Where in an order referring an industrial dispute to a Labour Court, Tribunal or National Tribunal under this Section or in a subsequent order, the appropriate Goverment has specified the points of dispute for adjudication, the Labour Court or the Tribunal or the National Tribunal, as the case may be, shall confine its adjudication to those points and matters incidental thereto. [Section 10(4)]

**G. Powers of the Government to add parties**

Where a dispute concerning any establishment of establishments has been, or is to be, referred to a Labour Court, Tribunal or National Tribunal under this Section and the appropriate Government is of opinion, whether on an application made to it in this behalf or otherwise, that the dispute is of such a nature that any other establishment, group or class of establishments of a similar nature is likely to be interested in, or affected by, such dispute, the appropriate Government may, at the time of making the reference or at any time thereafter but before the submission of the award, include in that reference such establishment, group or class of establishments, whether or not at the time of such inclusion any dispute exists or is apprehended in that establishment, group or class of establishments. [Section 10(5)]

## VOLUNTARY REFERENCE OF DISPUTES TO ARBITRATION

Section 10-A provides for the settlement of industrial disputes by voluntary reference of such dispute to arbitrators. To achieve this purpose, Section 10-A makes the following provisions:

a) Where any industrial dispute exists or is apprehended and the same has not yet been referred for adjudication to a Labour Court, Tribunal or National Tribunal, the employer and the workmen may refer the dispute, by a written agreement, to arbitration specifying the arbitrator or arbitrators. The presiding officer of a Labour Court or Tribunal or National Tribunal can also be named by the parties as arbitrator.

   Where an arbitration agreement provides for a reference of the dispute to an even number of arbitrators, the agreement shall provide for the appointment of another person as umpire who shall enter upon the reference, if the arbitrators are equally divided in their opinion, and the award of the umpire shall prevail and shall be deemed to be the arbitration award for the purposes of this Act.

b) An arbitration agreement referred to in sub-section (1) shall be in such form and shall be signed by the parties thereto in such manner as may be prescribed.

c) A copy of the arbitration agreement shall be forwarded to appropriate Government and the Conciliation Officer and the appropriate Government shall within one month from the date of the receipt of such copy, publish the same in the Official Gazette.

   According to Section 10-A(3A), where an industrial dispute has been referred to arbitration and the appropriate Government is satisfied that the persons making the reference represent the majority of each party, the appropriate Government may, within the time referred above, issue a notification in such manner as may be prescribed; and when any such notification is issued, the employer and workmen who are not parties to the arbitration agreement but are concerned in the dispute, shall be given an opportunity of presenting their case before the arbitrator or arbitrators.

d) The arbitrator or arbitrators shall investigate the dispute and submit to the appropriate Government the arbitration award signed by the arbitrator or all arbitrators, as the case may be.

e) Where an industrial dispute has been referred to arbitration and a notification has been issued, the appropriate Government may, by order, prohibit the continuance of any strike or lock-out in connection with such dispute which may be in existence on the date of the reference.

f) Nothing in the Arbitration Act, 1940 shall apply to arbitrations under this Section.

## STRIKES AND LOCK-OUTS

Strikes and lock-outs are the two weapons in the hands of workers and employers respectively, which they can use to press their viewpoints in the process of collective bargaining. The Industrial Disputes Act, 1947 does not grant an unrestricted right of strike or lock-out. Under Section 10(3) and Section 10A(4A), the Government is empowered to issue order for prohibiting continuance of strike or lock-out. Sections 22 and 23 make further provisions restricting the commencement of strikes and lock-outs.

**i. General prohibition of strikes and lock-outs**

No workman who is employed in any industrial establishment shall go on strike in breach of contract and no employer of any such workman shall declare a lock-out:

(a) during the pendency of conciliation proceedings before a Board and seven days the conclusion of such proceedings;

(b) during the pendency of proceedings before a Labour Court, Tribunal or National Tribunal and Mo months after the conclusion of such proceedings;

during the pendency of arbitration proceedings before an arbitrator and two months after the conclusion of such proceedings, where a notification has been issued under sub-section (3A) of Section 10A; or

(c) during any period in which a settlement or award is in operation, in respect of any of the matters covered by the settlement or award. (Section 23)

The purpose of above provisions is to ensure peaceful atmosphere during the pendency of any proceeding before a Conciliation Officer, Labour Court, Tribunal or National Tribunal or Arbitrator under Section 10A.

**ii. Prohibition of strikes and lock-outs in public utility service**

The abovementioned restrictions on strikes and lock-outs are applicable to both utility services and non-utility services. Section 22 provides for following additional safeguards for the smooth and uninterrupted running of public utility services and to obviate the possibility of inconvenience to the general public and society (State of Bihar v. Deodar Jha, AIR 1958 Pat. 51).

**1.** No person employed in a public utility service shall go on strike in breach of contract.

(a) without giving to the employer notice of strike, as hereinafter provided, within six weeks before striking, i.e., from the date of the notice to the date of strike a period of six weeks should not have elapsed; or

(b) within 14 days of giving of such notice, i.e., a period of 14 days must have elapsed from the date of notice to the date of strike; or

(c) before the expiry of the date of strike specified in any such notice as aforesaid, i.e., the date specified in the notice must have expired on the day of striking; or

(d) during the pendency of any conciliation proceedings before a conciliation officer and seven days after the conciliation of such proceedings.

**2.** No employer carrying on any public utility service shall lock-out any of his workmen:

(a) without giving them notice of lock-out as hereinafter provided within six weeks before locking-out; or

(b) within 14 days of giving such notice; or

(c) before the expiry of the date of lock-out specified in any such notice as aforesaid; or

(d) during the pendency of any conciliation proceedings before a Conciliation Officer and 7 days after the conciliation of such proceedings.

Right to Strike is to be exercised after complying with certain conditions regarding service of notice and also after exhausting intermediate and salutary remedy of conciliation proceedings (Dharam Singh Rajput v. Bank of lndia, Bombay, 1979 Lab. I.C. 1079).

The Act nowhere contemplates that a dispute would come into existence in any particular or specified manner. For coming into existence of an industrial dispute, a written demand is not a size qua non unless of course in the case of public utility service because Section 22 forbids going on strike without giving a strike notice (1978-1 Labour Law Journal 484 SC).

3. The notice of lock-out or strike under this Section shall not be necessary where there is already in existence a strike or, as the case may be, lock-out in the public utility service, but the employer shall send intimation of such lock-out or strike on the day on which it is declared, to such authority as may be specified by the appropriate Government either generally or for a particular area or for a particular class of public utility services.
4. The notice of strike referred to in Section 22(1) shall be given by such number of persons to such person or persons and in such manner as may be prescribed.
5. The notice of lock-out referred to in Section 22(2) shall be given in such manner as may be prescribed.
6. If on any day an employer receives from any persons employed by him any such notices as are referred to in sub-section (1) or gives to any persons employed by him any such notices as are referred to in subsection (2), he shall within five days thereof report to the appropriate Government or to such authority as that Government may prescribe the number of such notices received or given on that day. (Section 22)

**iii. Illegal strikes and lock-outs**

1. A strike or lock-out shall be illegal if:
   (i) it is commenced or declared in contravention of Section 22 or Section 23; or
   (ii) It is continued in contravention of an order made under Section 10(3) or Section 10A(4A).
2. Where a strike or lock-out in pursuance of an industrial dispute has already commenced and is in existence at the time of reference of the dispute to a Board, an arbitrator, a Labour Court, Tribunal or National Tribunal, the continuance of such strike or lock-out shall not be deemed to be illegal, provided that such strike or lock-out was not at its commencement in contravention of the provisions of this Act or the continuance thereof was not prohibited under Section 10(3) or Section 10A(4A).
3. A lock-out declared in consequence of an illegal strike or strike declared in consequence of an illegal lock-out shall not be deemed to be illegal. (Section 24)

No person shall knowingly expend or apply any money in direct furtherance or support of any illegal strike or lock-out (Section 25).

## UNFAIR LABOUR PRACTICES

A new Chapter VC relating to unfair labour practices has been inserted. Section 25T under this Chapter lays down that no employer or workman or a Trade Union, whether registered under the Trade Unions Act, 1926 or not, shall commit any unfair labour practice. Section 25U provides that any person who commits any unfair labour practice shall be punishable with imprisonment for a term which may extend to six months or with fine which may extend to one thousand rupees or with both.

## PENALTIES

1. **Penalty for illegal strikes**

   Any workman who commences, continues or otherwise acts in furtherance of a strike which is illegal under this Act, shall be punishable with imprisonment for a term which may extend to one month, or with fine which may extend to fifty rupees or with both. [Section 26(1)] In the case of Vijay Kumar Oil Mills v. Their Workmen, it was held that the act of a workman to participate in an illegal strike gives the employer certain rights against the workman, which are not the creation of the Statute but are based on policy, and the employer has every right to waive such rights. In a dispute before the Tribunal, waiver can be a valid defence by the workman. However, waiver by the employer cannot be a defence against prosecution under Section 26 and something which is illegal by Statute cannot be made legal by waiver (Punjab National Bank v. Their Workmen).

2. **Penalty for illegal lock-outs**

   Any employer who commences, continues, or otherwise, acts in furtherance of a lock-out which is illegal under this Act, shall be punishable with imprisonment for a term which may extend to one month, or with fine which may extend to one thousand rupees, or with both. [Section 26(2)]

3. **Penalty for instigation etc.**

   Any person who instigates or incites others to take part in, or otherwise acts in furtherance of, a strike or lock-out which is illegal under this Act, shall be punishable with imprisonment for a term which may extend to six months, or with fine which may extend to one thousand rupees, or with both. (Section 27)

4. **Penalty for giving financial aid to illegal strikes and lock-outs**

   Any person who knowingly expends or applies any money in direct furtherance or support of any illegal strike or lock-out shall be punishable with imprisonment for a term which may extend to six months, or with fine which may extend to one thousand rupees, or with both. (Section 28)

5. **Penalty for breach of settlement or award**

   Any person who commits a breach of any term of any settlement or award which is binding on him under this Act, should be punishable with imprisonment for a term which may extend to six months, or with fine or with both, and where the breach is a continuing one with a further fine which may extend to two hundred rupees for everyday during which the breach continues after the conviction for the first, and the Court trying the offence, if it fines the offender, may direct that the whole or any part of the fine realised from

him shall be paid, by way of compensation to any person who, in its opinion has been injured by such breach. (Section 29)

6. **Penalty for disclosing confidential information**

   Any person who wilfully discloses any such information as is referred to in Section 21 in contravention of the provisions of that section shall, on complaints made by or on behalf of the trade union or individual business affected, be punishable with imprisonment for a term which may extend to six months or with fine which may extend to one thousand rupees, or with both. (Section 30)

7. **Penalty for closure without notice**

   Any employer who closes down any undertaking without complying with the provisions of Section 25-FFA shall be punishable with imprisonment for a term which may extend to six months or with fine which may extend to five thousand rupees, or with both. (Section 30-A)

8. **Penalty for other offences**

   Any employer who contravenes the provisions of Section 33 shall be punishable with imprisonment for a term which may extend to six months, or with fine which may extend to one thousand rupees, or with both.

   Further, whoever contravenes any of the provisions of this Act or any rules made thereunder shall, if no other penalty is elsewhere provided by or under this Act for such contravention, be punishable with fine which may extend to one hundred rupees. (Section 31)

9. **Offence by companies, etc.**

   Where a person committing an offence under this Act is a company, or other body corporate, or an association of persons (whether incorporated or not) every director, manager, secretary, agent or other officer or person concerned with management thereof shall, unless he proves that the offence was committed without his knowledge or consent, be deemed to be guilty of such offence. (Section 32)

# Law of Industrial Relations

# Unit II – The Industrial Employment (Standing Orders) Act, 1946

## OBJECT AND SCOPE OF THE ACT

Main objects of this Act are:

Firstly, to enforce uniformity in the conditions of services under different employers in different industrial establishments.

Secondly, the employer, once having made the conditions of employment known to his employed workmen cannot change them to their detriment or to the prejudice of their rights and interests.

Thirdly, with the express or written conditions of employment, it is open for the prospective worker to accept them and join the industrial establishment.

Fourthly, for maintaining industrial peace and continued productivity, the significance of the express written conditions of employment cannot be minimised or exaggerated.

The object of the Act is to have uniform standing orders in respect of matters enumerated in the Schedule to the Act, applicable to all workers irrespective of their time of appointment [Barauni Refinery Pragati Sheet Parishad v. Indian Oil Corporation Ltd. (1991) SC].

### Applicability of the Act

The Act extends to the whole of India and applies to every industrial establishment wherein 100 or more workmen are employed or were employed on any day during the preceding twelve months.

Further, the appropriate Government may, after giving not less than 2 months notice of its intention to do so, by notification in the Official Gazette, extend the provisions of this Act to any industrial establishment employing such number of persons less than 100 as may be specified in the notification.

However, the Act does not apply to

1. any industry to which provisions of Chapter VII of the Bombay Industrial Relations Act, 1946, apply; or
2. any industrial establishment to which provisions of Madhya Pradesh Industrial Employment (Standing Orders) Act, 1961 apply.

Notwithstanding anything contained in the said Act, the provisions of this Act shall apply to all industrial establishments under the control of the Central Government.

Certified standing orders become part of the statutory and not contractual terms and conditions of service and are binding on both the employer and the employees [Derby Textiles Ltd. v. Karamchari and Shramik Union (1991)].

## Exemptions to certain establishments

Section 13-B of the Act specifically exempt certain industrial establishments from the purview of the Act, viz., the industrial establishment in so far as the workmen employed therein are persons to whom following rules and regulations are applied:

- the Fundamental and Supplementary Rules,
- Civil Services (Classification, Control and Appeal) Rules,
- Civil Service (Temporary Services) Rules,
- Revised Leave Rules,
- Civil Service Regulations,
- Civilians in Defence Service (Classification, Control and Appeal) Rules or
- the Indian Railway Establishment Code or
- any other rules or regulations that may be notified in this behalf by the appropriate Government in the Official Gazette apply.

Further, Section 14 provides that the appropriate Government may by notification in the Official Gazette exempt conditionally or unconditionally any industrial establishment or class of industrial establishments from all or any of the provisions of this Act.

# IMPORTANT DEFINITIONS

## Appropriate Government

| | |
|---|---|
| The Central Government | - in respect of industrial establishments: under the control of the Central Government or<br>- a Railway administration or<br>- in a major port,<br>- mine or<br>- oilfield, |
| The State Government | in all other cases |

Provided that where any question arises as to whether any industrial establishment is under the control of the Central Government, that Government may, either on a reference made to it by the employer or the workman or a trade union or other representative body of the workmen or on its own motion and after giving the parties an opportunity of being heard, decide the question and such decision shall be final and binding on the parties.

## Certifying Officer

"Certifying Officer" means

- a Labour Commissioner or
- a Regional Labour Commissioner,

and includes

any other officer appointed by the appropriate Government by notification in the Official Gazette, to perform all or any of the functions of a Certifying Officer under this Act.

## Employer

"Employer" means the owner of an industrial establishment to which this Act applies and also includes the following persons:

(i) A manager so named under Factories Act, 1948.

(ii) The head of the department or any authority appointed by the Government in any industrial establishment under its control.

(iii) Any person responsible to the owner for the supervision and control of any other industrial establishment which is not under the control of Government. [Section 2(d)]

## Industrial Establishment

It means:

(i) an industrial establishment defined under the Payment of Wages Act, 1936, or

(ii) a factory as defined under the Factories Act, 1948, or

(iii) a railway as defined under the Indian Railways Act, 1890, or

(iv) the establishment of a person who, for the purpose of fulfilling a contract with the owner of any industrial establishment, employs workmen.

## Standing Orders

"Standing Orders" means rules relating to matters set out in the Schedule to the Act. [Section 2(g)]

## Submission of draft Standing Orders by employers to the certifying officer

Section 3 provides that within 6 months from the date on which this Act becomes applicable to an industrial establishment, the employer of that establishment shall submit to the Certifying Officer five copies of the draft Standing Orders proposed by him for adoption in that establishment.

Such draft Standing Orders shall be in conformity with the Model Standing Orders if any, and, shall contain every matter set out in the Schedule which may be applicable to the industrial establishment.

The draft Standing Orders shall be accompanied by a statement containing prescribed particulars of the workmen employed in the industrial establishment including the name of the trade union, if any, to which they belong.

If the industrial establishment are of similar nature, a group of employers owning those industrial establishment may submit a joint draft of Standing Orders subject to such conditions as may be prescribed.

## Conditions for certification of Standing Orders

According to Section 4 of the Act, Standing Orders shall be certifiable if

(a) provision is made therein for every matter stated in the Schedule to the Act which is applicable to industrial establishment; and

(b) the Standing Orders are otherwise in conformity with the provisions of the Act.

## Fairness or reasonableness of Standing Orders

It is further provided in Section 4 that it shall be the function of the Certifying Officer or appellate authority to adjudicate upon the fairness or reasonableness of the provisions of the Standing Orders.

The Act, has imposed a duty on the Certifying Officer, to consider the reasonableness and fairness of the Standing Orders before certifying the same. The Certifying Officer is under a legal duty to consider that the Standing Orders are in conformity with the Act.

If the Certifying Officer finds that some provisions, as proposed by the employer relate to matters which are not included in the Schedule, or if he finds some provisions are unreasonable he must refuse to certify the same. Certification of any such Standing Order would be without jurisdiction.

Where a matter is not included in the Schedule and the concerned appropriate Government has not added any such item to the Schedule, neither the employer has a right to frame a Standing Order enabling him to transfer his employees nor the Certifying Officer has jurisdiction to certify the same. The consent of the employees to such standing orders would not make any difference (Air Gases Mazdoor Sangh, Varanasi v. Indian Air Gases Ltd., 1977).

## Certification of Standing Orders

Section 5 of the Act lays down the procedure to be followed by Certifying Officer.

On receipt of the draft Standing Order from the employer, the Certifying Officer shall forward a copy thereof:

- to the trade union of the workmen or
- where there is no trade union, then to the workmen in such manner as may be prescribed,

together with a notice requiring objections, if any, which the workmen may desire to make in the draft Standing Orders.

These objections are required to be submitted to him within 15 days from the receipt of the notice.

On receipt of such objections he shall provide an opportunity of being heard to the workmen or the employer and will make amendments, if any, required to be made therein and this will render the draft Standing Orders certifiable under the Act and he will certify the same. A copy of the certified Standing Orders will be sent by him to both the employer and the employees association within seven days of the certification.

**Register of Standing Orders:** Section 8 empowers the Certifying Officer to file a copy of all the Standing Orders as certified by him in a register maintained for the purpose in the prescribed form. He shall furnish a copy of the same to any person applying therefor on payment of the prescribed fee.

## APPEALS

According to Section 6 of the Act, the order of the Certifying Officer can be challenged by any employer, workman, trade union or any other prescribed representatives of the workmen, who can file an appeal before the appellate authority within 30 days from the date on which copies are sent to employer and the workers representatives.

The appellate authority, whose decision shall be final, has the power to confirm the Standing Orders as certified by the Certifying Officer or to amend them.

The appellate authority is required to send copies of the Standing Orders as confirmed or modified by it, to the employer or workers representatives within 7 days of its order.

## DATE OF OPERATION OF STANDING ORDERS

Standing Orders shall come into operation:

- on the expiry of 30 days from the date on which the authenticated copies are sent to employer and workers representatives or
- where an appeal has been preferred, they will become effective on the expiry of 7 days from the date on which copies of the order of the appellate authority are sent to employer and workers representatives. (Section 7)

## POSTING OF STANDING ORDERS

The text of the Standing Orders as finally certified under this Act shall be prominently posted by the employer in English and in the language understood by the majority of his workmen on special boards to be maintained for the purpose at or near the entrance through which the majority of the workmen enter the industrial establishment and, in all departments, thereof where the workmen are employed. (Section 9)

## DURATION AND MODIFICATION OF STANDING ORDERS

Section 10 prohibits an employer to modify the Standing Orders once they are certified under this Act except on agreement between the employer and the workmen or a trade union or other representative body of the workmen.

Such modification will not be affected until the expiry of 6 months from the date on which the Standing Orders were last modified or certified as the case may be.

This Section further empowers an employer or the workmen or a trade union or other representative body of the workmen to apply to the Certifying Officer to have the Standing Orders modified by making an application to the Certifying Officer. Such application should be accompanied by 5 copies of the proposed modifications and where such modifications are proposed to be made by agreement between the employer and the workmen or a trade union or other representative body of the workmen, a certified copy of such agreement should be filed along with the application.

Workmen are entitled to apply for modification of the Standing Orders.

Section 10(2) does not contain any time limit for making modification application. It can be made at any time. [Indian Express Employees Union v. Indian Express (Madurai) Ltd. (Ker)]

## PAYMENT OF SUBSISTENCE ALLOWANCE

Where any workman is suspended by the employer pending investigation or inquiry into complaints or charges of misconduct against him, the employer shall pay to such a workman the subsistence allowance:

(a) at the rate of 50% of the wages which the workman was entitled to immediately preceding the date of such suspension, for the first 90 days of suspension: and

(b) at the rate of 75% of such wages for the remaining period of suspension if the delay in the completion of disciplinary proceedings against such workman is not directly attributable to the conduct of such workman.

Any dispute regarding subsistence allowance may be referred by the workman or the employer, to the Labour Court constituted under the Industrial Disputes Act, 1947.

However, if the provisions relating to payment of subsistence allowance under any other law for the time being in force are more beneficial, then the provisions of such other law shall be applicable.

## INTERPRETATION OF STANDING ORDERS

Section 13-A of the Act provides that the question relating to application or interpretation of a Standing Order certified under this Act, can be referred to any Labour Court constituted under the Industrial Disputes Act, 1947 by:

- any employer or
- workman or
- a trade union or
- other representative body of the workmen.

The Labour Court to which the question is so referred, shall decide it after giving the parties an opportunity of being heard. Such decision shall be final and binding on the parties.

## TEMPORARY APPLICATION OF MODEL STANDING ORDERS

Section 12-A provides that for the period commencing on the date on which this Act becomes applicable to an industrial establishment and ending with the date on which the Standing Orders as finally certified under this Act come into operation in that establishment, the prescribed model Standing Orders shall be deemed to be adopted in that establishment.

**Matters to be provided in Standing Orders under this Act**

1. Classification of workmen, e.g., whether permanent, temporary, apprentices, probationers.
2. Manner of intimating to workmen periods and hours of work, holidays, pay-days and wage rates.
3. Shift working.
4. Attendance and late coming.
5. Conditions of, procedure in applying for, and the authority which may grant leave and holidays.
6. Requirement to enter premises by certain gates, and liability to search.
7. Closing and reopening of sections of the industrial establishment, and temporary stoppage of work and the rights and liabilities of the employer and workmen arising therefrom.
8. Termination of employment, and the notice thereof to be given by employer and workmen.
9. Suspension or dismissal for misconduct, and acts or omissions which constitute misconduct.
10. Means of redress for workmen against unfair treatment or wrongful exactions by the employer or his agents or servants.

# Chapter 17 : Law of Wages

## Unit I – Payment of Wages Act, 1936

### OBJECT AND SCOPE

- To eliminate all malpractices by laying down the time and mode of payment of wages as well as securing that the workers are paid their wages at regular intervals, without any unauthorised deductions.

### Definitions

"**Employed person**" includes the legal representative of a deceased employed person.

"**Employer**" includes the legal representative of a deceased employer.

"**Factory**" means a factory as defined under Factories Act 1948.

"**Industrial or other establishment**" means any —

(a) tramway service or motor transport service engaged in carrying passengers or goods or both by road;

(aa) air transport service other than such service belonging to or exclusively employed in the military naval or air forces of the Union or the Civil Aviation Department of the Government of India;

(b) dock wharf or jetty (dock refers to one or a group of human-made structures that are involved in the handling of boats or ships);

(c) inland vessel mechanically propelled (every description of vessel propelled wholly or in part by electricity, steam or other mechanical power);

(d) mine quarry or oil-field (A quarry is a type of mine called an open-pit mine, because it is open to Earth's surface);

(e) plantation;

(f) workshop or other establishment in which articles are produced adapted or manufactured with a view to their use transport or sale;

(g) establishment in which any work relating to the construction development or maintenance of buildings, roads bridges or canals or relating to operations connected with navigation irrigation or to the supply of water or relating to the generation transmission and distribution of electricity or any other form of power is being carried on;

(h) any other establishment or class of establishments which the Appropriate Government may having regard to the nature thereof the need for protection of persons employed therein and other relevant circumstances specify by notification in the Official Gazette. [Section 2(ii)]

"**Wages**" means all remuneration (whether by way of salary allowances or otherwise) expressed in terms of money payable to a person employed in respect of his employment or of work done in such employment and includes —

(a) any remuneration payable **under any award or settlement** between the parties or order of a court;

(b) any remuneration in respect of **overtime work or holidays or any leave period;**

(c) any additional remuneration payable under the terms of employment (bonus);

(d) any sum which by reason of the termination of employment of the person employed is payable under any law contract or instrument which provides for the payment of such sum;

(e) any sum to which the person employed is entitled under any scheme framed under any law for the time being in force, but does not include —

(1) any bonus other than above which does not form part of the remuneration payable under the terms of employment or which is not payable under any award or settlement between the parties or order of a court;

(2) the value of any house-accommodation or of the supply of light, water, medical attendance or other amenity or of any service excluded from the computation of wages by a general or special order of Appropriate Government;

(3) any contribution paid by the employer to any pension or provident fund and the interest which may have accrued thereon;

(4) any travelling allowance or the value of any travelling concession;

(5) any sum paid to the employed person to defray special expenses entailed on him by the nature of his employment; or

(6) any gratuity payable on the termination of employment in cases other than those specified in subclause (d).

## Responsibility for payment of wages

Section 3 provides that **every employer shall be responsible** for the payment to persons employed by him of all wages required to be paid under the Act.

However,

- in the case of persons employed in factories if a **person has been named as the manager** of the factory;
- in the case of persons employed in industrial or other establishments if there is a person responsible to the employer for the supervision and control of the industrial or other establishments;
- in the case of persons employed upon railways if the employer is the railway administration and the railway administration has nominated a person in this behalf for the local area concerned;
- in the case of persons employed in the work of contractor, a person designated by such contractor who is directly under his charge;
- and in any other case, a person designated by the employer as a person responsible for complying with the provisions of the Act,

shall be responsible for such payment.

## Fixation of wage period

As per section 4 of the Act every person responsible for the payment of wages shall fix wage-periods in respect of which such wages shall be payable.

No wage-period shall exceed one month.

## Time payment of wages (Section 5)

- The wages of every person employed upon or in any
  - **railway factory or**
  - **industrial or other establishment**

  **upon or in which less than 1000 persons are employed,** shall be paid before the expiry of the 7th day.
- The wages of every person employed upon or in **any other railway factory or industrial or other establishment** shall be paid before the expiry of the 10th day, after the last day of the wage-period in respect of which the wages are payable.
- In the case of persons employed on a **dock wharf or jetty or in a mine** the balance of wages found due on completion of the final tonnage account of the ship or wagons loaded or unloaded as the case may be shall be paid before the expiry of the 7th day from the day of such completion.
- Where the employment of any person is terminated by or on behalf of the employer the wages earned by him shall be paid before the expiry of the 2nd working day from the day on which his employment is terminated.
- Where the employment of any person in an establishment is terminated due to the closure of the establishment for any reason other than a weekly or other recognised holiday the wages earned by him shall be paid before the expiry of the 2nd day from the day on which his employment is so terminated.

**All payments of wages shall be made on a working day.**

## Wages to be paid in current coin or currency notes or by cheque or crediting in bank account

As per section 6 of the Act, all wages shall be paid in

- current coin or
- currency notes or
- by cheque or
- by crediting the wages in the bank account of the employee:

Provided that the appropriate Government may specify the industrial or other establishment, the employer of which shall pay to every person employed in such industrial or other establishment, **the wages only by cheque or by crediting the wages in his bank account.**

## Deductions from the wages of an employee

Section 7 of the Act allows deductions from the wages of an employee on the account of the following: -

i. fines;
ii. absence from duty;

iii. damage to or loss of goods expressly entrusted to the employee;
iv. housing accommodation and amenities provided by the employer;
v. recovery of advances or adjustment of over-payments of wages;
vi. recovery of loans made from any fund constituted for the welfare of labour and the interest due in respect thereof;
vii. subscriptions to and for repayment of advances from any provident fund;
viii. income-tax;
ix. payments to co- operative societies approved by the State Government or to a scheme of insurance maintained by the Indian Post Office;
x. deductions made with the written authorisation of the employee for payment of any premium on his life insurance policy or purchase of securities.

## Fines (Section 8)

(1) No fine shall be imposed on any employed person save in respect of such acts and omissions on his part as the employer may have specified by notice under sub-section (2).

(2) A notice specifying such acts and omissions shall be exhibited in the prescribed manner on the premises in which the employment carried on or in the case of persons employed upon a railway (otherwise than in a factory) at the prescribed place or places.

(3) No fine shall be imposed on any employed person until he has been given an opportunity of showing cause against the fine.

(4) The total amount of fine which may be imposed in any one wage-period on any employed person shall not exceed an amount equal to 3% of the wages payable to him in respect of that wage period.

(5) No fine shall be imposed on any employed person who is under the age of 15 years.

(6) No fine imposed on any employed person shall be recovered from him by instalments or after the expiry of 90 days from the day on which it was imposed.

(7) Every fine shall be deemed to have been imposed on the day of the act or omission in respect of which it was imposed.

(8) All fines and all realisations thereof shall be recorded in a register to be kept by the person responsible for the payment of wages under section 3 in such form as may be prescribed; and all such realisations shall be applied only to such purposes beneficial to the persons employed in the factory or establishment as are approved by the prescribed authority.

## Maintenance of registers and records

Section 13A provides that every employer shall maintain such registers and records giving such particulars of:

- persons employed by him,
- the work performed by them,
- the wages paid to them,
- the deductions made from their wages,
- the receipts given by them and such other particulars in prescribed form.

Every register and record required to be maintained shall be preserved for a period of 3 years after the date of the last entry made therein.

## Claims arising out of deductions from wages or delay in payment of wages and penalty for malicious or vexatious claims (Section 15)

Section 15(1) provides that the appropriate Government may appoint -

(a) any Commissioner for Workmen's Compensation; or

(b) any officer of the Central Government exercising functions as -

- Regional Labour Commissioner; or
- Assistant Labour Commissioner with at least 2 years' experience; or

(c) any officer of the State Government not below the rank of Assistant Labour Commissioner with at least 2 years' experience; or

(d) a presiding officer of any Labour Court or Industrial Tribunal, constituted under the Industrial Disputes Act, 1947 or under any corresponding law relating to the investigation and settlement of industrial disputes in force in the State; or

(e) any other officer with experience as a Judge of a Civil Court or a Judicial Magistrate, as the authority to hear and decide for any specified area all claims arising out of deductions from the wages, or delay in payment of the wages, of persons employed or paid in that area.

Provided that where the appropriate Government considers it necessary to do so, it may appoint more than one authority for any specified area and may, by general or special order, provide for the distribution or allocation of work to be performed by them under this Act.

Section 15(2) provides that where contrary to the provisions of the Act any deduction has been made from the wages of an employed person or any payment of wages has been delayed

- such person himself or
- any legal practitioner or
- any official of a registered trade union authorised in writing to act on his behalf or
- any Inspector under this Act or
- any other person acting with the permission of the authority appointed under sub-section (1)

may apply to such authority for a direction under sub-section (3).

However, every such application shall be presented within 12 months from the date on which the deduction from the wages was made or from the date on which the payment of the wages was due to be made as the case may be.

Any application may be admitted after the said period of 12 months when the applicant satisfies the authority that he had sufficient cause for not making the application within such period.

Section 15(3) states that when any application under sub-section (2) is entertained, the authority shall hear the applicant and the employer or other person responsible for the payment of wages under section 3, or give them an opportunity of being heard, and, after such further enquiry, if any, as may be necessary, may **direct the refund to the employed person**

**of the amount deducted, or the payment of the delayed wages, together with the payment of such compensation as the authority may think fit,** not exceeding 10 times the amount deducted in the case of amount deducted and not exceeding Rs. 3,000 but not less than Rs. 1,500 in case of payment of delayed wages, and even if the amount deducted or delayed wages are paid before the disposal of the application, direct the payment of such compensation, as the authority may think fit, not exceeding Rs. 2,000.

A claim under the Act shall be disposed of as far as practicable within a period of 3 months from the date of registration of the claim by the authority. It may be noted that the period of 3 months may be extended if both parties to the dispute agree for any bona fide reason to be recorded by the authority that the said period of 3 months may be extended to such period as may be necessary to dispose of the application in a just manner.

No direction for the payment of compensation shall be made in the case of delayed wages if the authority is satisfied that the delay was due to-

(a) a bona fide error or bona fide dispute as to the amount payable to the employed person; or

(b) the occurrence of an emergency, or the existence of exceptional circumstances, the person responsible for the payment of the wages was unable, in spite of exercising reasonable diligence; or

(c) the failure of the employed person to apply for or accept payment.

Section 15(4) states that if the authority hearing an application under this section is satisfied

- that the application was either malicious or vexatious, the authority may direct that a penalty not exceeding Rs. 375 be paid to the employer or other person responsible for the payment of wages by the person presenting the application; or
- that in any case in which compensation is directed to be paid under sub-section (3), the applicant ought not to have been compelled to seek redress under this section the authority may direct that a penalty not exceeding Rs. 375 be paid to the appropriate Government by the employer or other person responsible for the payment of wages.

# Law of Wages

## Unit II – Minimum Wages Act, 1948

An Act to provide for fixing minimum rates of wages in certain employments.

The employments are those which are included in the schedule and are referred to as 'Scheduled Employments'.

## OBJECT AND SCOPE OF THE LEGISLATION

The philosophy of the Minimum Wages Act and its significance in the context of conditions in India, has been explained by the Supreme Court in Unichoyi v. State of Kerala (1962 SC), as follows:

"What the Minimum Wages Act purports to achieve is:

- To prevent exploitation of labour and for that purpose empowers the appropriate Government to take steps to prescribe minimum rates of wages in the scheduled industries. In an underdeveloped country which faces the problem of unemployment on a very large scale, it is not unlikely that labour may offer to work even on starvation wages.
- The policy of the Act is to prevent the employment of such sweated labour in the interest of general public and so in prescribing the minimum rates, the capacity of the employer need not to be considered. What is being prescribed is minimum wage rates which a welfare State assumes every employer must pay before he employs labour".

## IMPORTANT DEFINITIONS

### Appropriate Government

"Appropriate Government" means —

| | |
|---|---|
| Central Government | in relation to any scheduled employment carried on by or under the authority of the Central or a railway administration, or<br>in relation to a mine,<br>oilfield or<br>major port or<br>any corporation established by a Central Act |
| State Government | in relation to any other scheduled employment |

### Employee [Section 2(i)]

"Employee" means any person who is employed to do any work, skilled or unskilled, manual or clerical in a scheduled employment in respect of which minimum rates of wages have been fixed; and

includes an outworker to whom any articles or materials are given out by another person to be made up, cleaned, washed, altered, ornamented, finished, repaired, adapted or otherwise processed for sale purpose of the trade or business of that other person and also

includes an employee declared to be an employee by the appropriate Government;

but does not include any member of Armed Forces of the Union.

## Employer [Section 2(e)]

"Employer" means any person who employs one or more employees in any scheduled employment in respect of which minimum rates of wages have been fixed under this Act, and includes:

(i) in a factory where there is carried on any scheduled employment in respect of which minimum rates of wages have been fixed under this Act,

any person named as manager of the factory;

(ii) in any scheduled employment under the control of any Government in India in respect of which minimum rates of wages have been fixed under this Act,

the person or authority appointed by such Government for the supervision and control of employees or

where no person of authority is so appointed, the Head of the Department;

(iii) in any scheduled employment under any local authority in respect of which minimum rates of wages have been fixed under this Act

the person appointed by such authority for the supervision and control of employees or

where no person is so appointed, the Chief Executive Officer of the local authority;

(iv) in any other case where there is carried on any scheduled employment in respect of which minimum rates of wages have been fixed under this Act,

any person responsible to the owner of the supervision and control of the employees or for the payment of wages.

The definitions of "employees" and "employer" are quite wide.

- Person who engages workers through another like a contractor would also be an employer.
- It was held in Nathu Ram Shukla v. State of Madhya Pradesh that if minimum wages have not been fixed for any branch of work of any scheduled employment, the person employing workers in such branch is not an employer with the meaning of the Act.
- In case of Loknath Nathu Lal v. State of Madhya Pradesh an out-worker who prepared goods at his residence, and then supplied them to his employer was held as employee for the purpose of this Act.

## Scheduled employment [Section 2(g)]

"Scheduled employment" means an employment specified in the Schedule or any process or branch of work forming part of such employment.

## Wages [Section 2(i)]

"Wages" means all remunerations capable of being expressed in terms of money, which would be payable to a person employed in respect of his employment or of work done in such employment and includes house rent allowance

but does not include:

(i) the value of:

(a) any house accommodation, supply of light, water medical;

(b) any other amenity or any service excluded by general or social order of the appropriate Government;

(ii) contribution by the employer to any Pension Fund or Provides Fund or under any scheme of social insurance;

(iii) any traveling allowance or the value of any traveling concession;

(iv) any sum paid to the person employed to defray special expenses entailed on him by the nature of his employment;

(v) any gratuity payable on discharge.

## FIXATION OF MINIMUM RATES OF WAGES [SECTION 3]

Section 3(1)(a) lays down that the 'appropriate Government' shall fix the minimum rates of wages, payable to employees in an employment specified in Part I and Part II of the Schedule.

In case of the employments specified in Part II of the Schedule, the minimum rates of wages may not be fixed for the entire State. Parts of the State may be left out altogether.

In case of an employment specified in Part I, the minimum rates of wages must be fixed for the entire State, no parts of the State being omitted.

The rates to be fixed need not be uniform. Different rates can be fixed for different zones or localities:

Notwithstanding the provisions of Section 3(1)(a), the "appropriate Government" may not fix minimum rates of wages in respect of any scheduled employment in which less than 1000 employees in the whole State are engaged. But when it comes to its knowledge after a finding that this number has increased to 1,000 or more in such employment, it shall fix minimum wage rate.

## REVISION OF MINIMUM WAGES

According to Section 3(1)(b), the 'appropriate Government' may review at such intervals as it may think fit, such intervals not exceeding 5 years, and revise the minimum rate of wages, if necessary.

This means that minimum wages can be revised earlier than 5 years also.

## MANNER OF FIXATION/REVISION OF MINIMUM WAGES

According to Section 3(2), the 'appropriate Government' may fix minimum rate of wages for:

(a) time work, known as a Minimum Time Rate;

(b) piece work, known as a Minimum Piece Rate;

(c) a "Guaranteed Time Rate" for those employed in piece work for the purpose of securing to such employees a minimum rate of wages on a time work basis, and

(d) a "Over Time Rate" i.e. minimum rate whether a time rate or a piece rate to apply in substitution for the minimum rate which would otherwise be applicable in respect of overtime work done by employee.

Section 3(3) provides that different minimum rates of wages may be fixed for —

(i) different scheduled employments;

(ii) different classes of work in the same scheduled employments;

(iii) adults, adolescents, children and apprentices;

(iv) different localities

Further, minimum rates of wages may be fixed by any one or more of the following wage periods, namely:

(i) by the hour,

(ii) by the day,

(iii) by the month, or

(iv) by such other large wage periods as may be prescribed.

## MINIMUM RATE OF WAGES (SECTION 4)

According to Section 4 of the Act, any minimum rate of wages fixed or revised by the appropriate Government under Section 3 may consist of —

(i) a basic rate of wages and a special allowance at a rate to be adjusted with the variation in the cost of living index number applicable to such worker (hereinafter referred to as the cost of living allowance); or

(ii) a basic rate of wages without the cost of living allowance and the cash value of the concession in respect of supplies of essential commodities at concessional rates where so authorized; or

(iii) an all inclusive rate allowing for the basic rate, the cost of living allowance and the cash value of the concessions, if any.

## PROCEDURE FOR FIXING AND REVISING MINIMUM WAGES (SECTION 5)

In fixing minimum rates of wages in respect of any scheduled employment for the first time or in revising minimum rates of wages, the appropriate Government can follow either of the two methods described below.

### First Method [Section 5(1)(a)]

This method is known as the 'Committee Method'. The appropriate Government may appoint as many committees and sub-committees as it considers necessary to hold enquiries and advise it in respect of such fixation or revision as the case may be. After considering the advise of the committee or committees, the appropriate Government shall, by notification in the Official Gazette fix or revise the minimum rates of wages.

The wage rates shall come into force from such date as may be specified in the notification. If no date is specified, wage rates shall come into force on the expiry of three months from the date of the issue of the notification.

Note: It was held in Edward Mills Co. v. State of Ajmer (1955) that Committee appointed under Section 5 is only an advisory body and that Government is not bound to accept its recommendations.

As regards composition of the Committee, Section 9 of the Act lays down that it shall consist of persons to be nominated by the appropriate Government representing employers and employee in the scheduled employment, who shall be equal in number and independent persons not exceeding 1/3rd of its total number of members. One of such independent persons shall be appointed as the Chairman of the Committee by the appropriate Government.

### Second Method [Section 5(1)(b)]

The method is known as the 'Notification Method'. When fixing minimum wages under Section 5(1)(b), the appropriate Government shall by notification, in the Official Gazette publish its proposals for the information of persons likely to be affected thereby and specify a date not less than 2 months from the date of notification, on which the proposals will be taken into consideration.

The representations received will be considered by the appropriate Government. It will also consult the Advisory Board constituted under Section 7 and thereafter fix or revise the minimum rates of wages by notification in the Official Gazette. The new wage rates shall come into force from such date as may be specified in the notification. However, if no date is specified, the notification shall come into force on expiry of three months from the date of its issue. Minimum wage rates can be revised with retrospective effect.

### Advisory Board

The advisory board is constituted under Section 7 of the Act by the appropriate Government for the purpose of co-ordinating the work of committees and sub-committees appointed under Section 5 of the Act and advising the appropriate Government generally in the matter of fixing and revising of minimum rates of wages.

According to Section 9 of the Act, the advisory board shall consist of persons to be nominated by the appropriate Government representing employers and employees in the scheduled employment who shall be equal in number, and independent persons not exceeding 1/3rd of its total number of members, one of such independent persons shall be appointed as the Chairman by the appropriate Government.

An independent person in the context of Section 9 means a person who is neither an employer nor an employee in the employment for which the minimum wages are to be fixed. In the case of State of Rajasthan v. Hari Ram Nathwani, (1975), it was held that the mere fact that a person happens to be a Government servant will not divert him of the character of the independent person.

## CENTRAL ADVISORY BOARD

Section 8 of the Act provides that the Central Government shall appoint a Central Advisory Board for the purpose of advising the Central Government and State Governments in the matters of fixation and revision of minimum rates of wages and other matters under the Minimum Wages Act and for coordinating work of the advisory boards.

The Central Advisory Board shall consist of persons to be nominated by the Central Government representing employers and employees in the scheduled employment who shall be equal in number and independent persons not exceeding 1/3'd of its total number of members,

one of such independent persons shall be appointed as the Chairman of the Board by Central Government.

## MINIMUM WAGE — WHETHER TO BE PAID IN CASH OR KIND

Section 11 of the Act provides that minimum wages payable under the Act shall be paid in cash.

But where it has been the custom to pay wages wholly or partly in kind, the appropriate Government, on being satisfied, may approve and authorize such payments. Such Government can also authorize for supply of essential commodities at concessional rates. Where payment is to be made in kind, the cash value of the wages in kind or in the shape of essential commodities on concessions shall be estimated in the prescribed manner.

## PAYMENT OF MINIMUM WAGES IS OBLIGATORY ON EMPLOYER (SECTION 12)

Payment of less than the minimum rates of wages notified by the appropriate Government is an offence.

Section 12 clearly lays down that the employer shall pay to every employee engaged in a scheduled employment under him such wages at a rate not less than the minimum rate of wages fixed by the appropriate Government under Section 5 for that class of employment without deduction except as may be authorized, within such time and subject to such conditions, as may be prescribed.

## FIXING HOURS FOR A NORMAL WORKING DAY (SECTION 13)

Fixing of minimum rates of wages without reference to working hours may not achieve the purpose for which wages are fixed. Thus, by virtue of Section 13 the appropriate Government may —

(a) fix the number of hours which shall constitute a normal working day, inclusive of one or more specified intervals;

(b) provide for a day of rest in every period of 7 days which shall be allowed to all employees or to any specified class of employees and for the payment of remuneration in respect of such day of rest;

(c) provide for payment of work on a day of rest at a rate not less than the overtime rate.

The above stated provision shall apply to following classes of employees only to such extent and subject to such conditions as may be prescribed:

(a) Employees engaged on urgent work, or in any emergency, which could not have been foreseen or prevented;

(b) Employees engaged in work in the nature of preparatory or complementary work which must necessarily be carried on outside the limits laid down for the general working in the employment concerned;

(c) Employees whose employment is essentially intermittent;

(d) Employees engaged in any work which for technical reasons, has to be completed before the duty is over;

(e) Employees engaged in any work which could not be carried on except at times dependent on the irregular action of natural forces.

There is correlation between minimum rates of wages and hours of work. Minimum wages are to be fixed on basis of standard normal working hours, namely 48 hours a week; (Benode Bihari Shah v. State of W.B. 1976 (Cal)).

## PAYMENT OF OVERTIME (SECTION 14)

Section 14 provides that when an employee, whose minimum rate of wages is fixed under this Act by the hours, the day or by such longer wage period as may be prescribed, works on any day in excess of the number of hours constituting a normal working day, the employer shall pay him for every hour or part of an hour so worked in excess at the overtime rate fixed under this Act or under any other law of the appropriate Government for the time being in force whichever is higher.

Payment for overtime work can be claimed only by the employees who are getting minimum rate of wages under the Act and not by those getting better wages. (1998 LU I SC 815).

## WAGES OF A WORKER WHO WORKS LESS THAN NORMAL WORKING DAY (SECTION 15)

Where the rate of wages has been fixed under the Act by the day for an employee and if he works on any day on which he employed for a period less than the requisite number of hours constituting a normal working day, he shall be entitled to receive wages for that day as if he had worked for a full working day.

Provided that he shall not receive wages for full normal working day —

(i) if his failure to work is caused by his unwillingness to work and not by omission of the employer to provide him with work, and

(ii) such other cases and circumstances as may be prescribed.

## MAINTENANCE OF REGISTERS AND RECORDS (SECTION 18)

Apart from the payment of the minimum wages, the employer is required under Section 18 to maintain registers and records giving such particulars of employees under his employment,

- the work performed by them,
- the receipts given by them and
- such other particulars as may be prescribed.

Every employee is required also to exhibit notices, in the prescribed form containing particulars in the place of work. He is also required to maintain wage books or wage-slips as may be prescribed by the appropriate Government and the entries made therein will have to be authenticated by the employer or his agent in the manner prescribed by the appropriate Government.

## AUTHORITY AND CLAIMS (SECTION 20-21)

Under Section 20(1) of the Act, the appropriate Government, may appoint any of the following as an authority to hear and decide for any specified area any claims arising out of payment of less than the minimum rate of wages or in respect of the payment of remuneration for the days of rest or of wages at the rate of overtime work:

(a) any Commissioner for Workmen's Compensation; or

(b) any officer of the Central Government exercising functions as Labour Commissioner for any region;or

(c) any officer of the State Government not below the rank of Labour Commissioner; or

(d) any other officer with experience as a Judge of a Civil Court or as the Stipendiary Magistrate.

The authority so appointed shall have jurisdiction to hear and decide claim arising out of payment of less than the minimum rates of wages or in respect of the payment remuneration for days of rest or for work done on such days or for payment of overtime.

The provisions of Section 20(1) are attracted only if there exists a disputed between the employer and the employee as to the rates of wages. Where no such dispute exists between the employer and employees and the only question is whether a particular payment at the agreed rate in respect of minimum wages, overtime or work on off days is due to an employee or not, the appropriate remedy is provided by the Payment of Wages Act, 1936.

## OFFENCES AND PENALTIES

Section 22 of the Act provides that any employer who

a. pays to any employee less than the minimum rates of wages fixed for that employee's class of work or less than the amount due to him under the provisions of this Act or
b. contravenes any rule or order made under Section 13,

shall be punishable with imprisonment for a term which may extend to 6 months or with fine which may extend to Rs. 500 or with both.

While imposing any fine for an offence under this section the court shall take into consideration the amount of any compensation already awarded against the accused in any proceedings taken under section 20.

It is further stipulated under Section 22A of the Act that any employer who contravenes any provision of this Act or of any rule or order made thereunder shall if no other penalty is provided for such contravention by this Act be punishable with fine which may extend to Rs. 500.

# Law of Wages

## Unit III – Payment of Bonus Act, 1965

The Payment of Bonus Act, 1965 provides for the payment of bonus to persons employed in certain establishments and for matters connected therewith.

## OBJECT AND SCOPE OF THE ACT

The object of the Act is to provide for the payment of bonus to persons employed in certain establishments and for matters connected therewith. Shah J. observed in Jalan Trading Co. (Pvt.) Ltd. v. Mill Mazdor Sabha, AIR 1967 S.C. 691, that the "object of the Act being to maintain peace and harmony between labour and capital by allowing the employees to share the prosperity of the establishment and prescribing the maximum and minimum rates of bonus together with the scheme of "set-off' and "set on" not only secures the right of labour to share in the profits but also ensures a reasonable degree of uniformity".

On the question whether the Act deals only with profit bonus, it was observed by the Supreme Court in Mumbai Kamgar Sabha v. Abdulbhai Faizullabhai, (1976) II LU 186, that "bonus" is a word of many generous connotations and, in the Lord's mansion, there are many houses. There is profit based bonus which is one specific kind of claim and perhaps the most common. There is customary or traditional bonus which has its emergence from long, continued usage leading to a promissory and expectancy situation materialising in a right. There is attendance bonus and what not. The Bonus Act speak and speaks as a whole Code on the sole subject of profit based bonus but is silent and cannot, therefore, annihilate by implication, other distinct and different kinds of bonuses, such as the one oriented on custom. The Bonus Act, 1965 as it then stood does not bar claims to customary bonus or those based on conditions of service. Held, a discerning and concrete analysis of the scheme of the Bonus Act and reasoning of the Court leaves no doubt that the Act leaves untouched customary bonus.

The provision of the Act have no say on customary bonus and cannot, therefore, be inconsistent therewith. Conceptually, statutory bonus and customary bonus operate in two fields and do not clash with each other (Hukamchand Jute Mills Limited v. Second Industrial Tribunal, West Bengal; 1979-1 Labour Law Journal 461).

## APPLICATION OF THE ACT

According to Section 1(2), the Act extends to the whole of India, and as per Section 1(3) the Act shall apply to

(a) every factory; and

(b) every other establishment in which twenty or more persons are employed on any day during an accounting year.

Provided that the appropriate Government may, after giving not less than two months notice of its intention so to do, by notification in the Official Gazette apply the provisions of this Act with effect from such accounting year as may be specified in the notification to any establishment including an establishment being a factory within the meaning of sub-clause (ii) of clause (m) of Section 2 of the Factories Act, 1948 employing such number of persons less

than twenty as may be specified in the notification; so, however, that the number of persons so specified shall in no case be less than ten.

Save as otherwise provided in this Act, the provisions of this Act shall, in relation to a factory or other establishment to which this Act applies, have effect in respect of the accounting year commencing on any day in the year 1964 and in respect of every subsequent accounting year:

Provided that in relation to the State of Jammu and Kashmir, the reference to the accounting year commencing on any day in the year 1964 and every subsequent accounting year shall be construed as reference to the accounting year commencing on any day in the year 1968 and every subsequent accounting year.

Provided further that when the provisions of this Act have been made applicable to any establishment or class of establishments by the issue of a notification under the proviso to sub-section (3), the reference to the accounting year commencing on any day in the year 1964 and every subsequent accounting year, or, as the case may be, the reference to the accounting year commencing on any day in the year 1968 and every subsequent accounting year, shall, in relation to such establishment or class of establishments, be construed as a reference to the accounting year specified in such notification and every subsequent accounting year [Section 1(4)].

An establishment to which this Act applies shall continue to be governed by this Act notwithstanding that the number of persons employed therein falls below twenty, or, as the case may be, the number specified in the notification issued under the proviso to sub-section (3).

## ACT NOT TO APPLY TO CERTAIN CLASSES OF EMPLOYEES

Section 32 of this Act provides that the Act shall not apply to the following classes of employees:

(i) employees employed by any insurer carrying on general insurance business and the employees employed by the Life Insurance Corporation of India;

(ii) seamen as defined in clause (42) of Section 3 of the Merchant Shipping Act, 1958;

(iii) employees registered or listed under any scheme made under the Dock Workers (Regulation of Employment) Act, 1948 and employed by registered or listed employers;

(iv) employees employed by an establishment engaged in any industry called on by or under the authority of any department of Central Government or a State Government or a local authority;

(v) employees employed by:

  (a) the Indian Red Cross Society or any other institution of a like nature including its branches;

  (b) universities and other educational institutions;

  (c) institutions (including hospitals, chambers of commerce and social welfare institutions) established not for the purpose of profit;

(vi) (omitted);

(vii) (omitted);

(viii) employees employed by the Reserve Bank of India;

(ix) employees employed by:

(a) the Industrial Finance Corporation of India;

(b) any Financial Corporation established under Section 3, or any Joint Financial Corporation established under Section 3A of the State Financial Corporations Act, 1951;

(c) the Deposit Insurance Corporation;

(d) the National Bank for Agriculture and Rural Development;

(e) the Unit Trust of India;

(f) the Industrial Development Bank of India;

(g) the Small Industries Development Bank of India established under Section 3 of the Small Industries Development Bank of India Act, 1989;

(h) the National Housing Bank;

(i) any other financial Institution (other than Banking Company) being an establishment in public sector, which the Central Government may by notification specify having regard to

- its capital structure;
- its objectives and the nature of its activities;
- the nature and extent of financial assistance or any concession given to it by the Government; and
- any other relevant factor;

(x) (omitted);

(xi) employees employed by inland water transport establishments operating on routes passing through any other country.

Apart from the above, the appropriate Government has necessary powers under Section 36 to exempt any establishment or class of establishments from all or any of the provisions of the Act for a specified period having regard to its financial position and other relevant circumstances and if it is of the opinion that it will not be in the public interest to apply all or any of the provisions of this Act thereto. It may also impose such conditions while according the exemptions as it may consider fit to impose.

## IMPORTANT DEFINITIONS

### Accounting Year

"Accounting Year" means

(i) in relation to a corporation, the year ending on the day on which the books and accounts of the corporation are to be closed and balanced;

(ii) in relation to a company, the period in respect of which any profit and loss account of the company laid before it in annual general meeting is made up, whether that period is a year or not;

(iii) in any other case:

(a) the year commencing on the 1st day of April; or

(b) if the accounts of an establishment maintained by the employer thereof are closed and balanced on any day other than the 31st day of March, then, at the option of the employer, the year ending on the day on which its accounts are so closed and balanced.

Provided that an option once exercised by the employer under paragraph (b) of this sub-clause shall not again be exercised except with the previous permission in writing of the prescribed authority and upon such conditions as that authority may think fit. [Section 2(1)]

## Allocable Surplus

It means: -

(a) in relation to an employer, being a company (other than a banking company) which has not made the arrangements prescribed under the Income-tax Act for the declaration and payment within India of the dividends payable out of its profits in accordance with the provisions of Section 194 of that Act, sixtyseven per cent of the available surplus in an accounting year;

(b) in any other case sixty per cent of such available surplus. [Section 2(4)]

## Available Surplus

It means the available surplus under Section S. [Section 2(6)]

## Award

"Award" means an interim or a final determination of any industrial dispute or of any question relating thereto by any Labour Court, Industrial Tribunal or National Tribunal Constituted under the Industrial Disputes Act, 1947 or by any other authority constituted under any corresponding law relating to investigation and settlement of industrial disputes in force in a State and includes an arbitration award made under Section 10A of that Act or under that law. [Section 2(7)]

## Corporation

"Corporation" means any body corporate established by or under any Central, Provincial or State Act but does not include a company or a co-operative society. [Section 2(11)]

## Employee

"Employee" means any person (other than an apprentice) employed on a salary or wages not exceeding Rs. 21,000/- per mensem in any industry to do any skilled or unskilled, manual, supervisory, managerial, administrative, technical or clerical work of hire or reward, whether the terms of employment be express or implied. [Section 2(13)]

## Employer

"Employer" includes:

(a) in relation to an establishment which is a factory, the owner or occupier of the factory, including the agent of such owner or occupier, the legal representative of a deceased owner or occupier, and where a person has been named as a manager of the factory under Clause (f) of Sub-section 7(1) of the Factories Act, 1948, the person so named; and

(b) in relation to any other establishment, the person who, or the authority which, has the ultimate control over the affairs of the establishment and where the said affairs are entrusted to a manager, managing director or managing agent, such manager, managing director or managing agent. [Section 2(14)]

## Establishment in Private Sector

It means any establishment other than an establishment in public sector. [Section 2(15)]

## Establishment in Public Sector

It means an establishment owned, controlled or managed by:

(a) a Government company as defined in Section 617 of the Companies Act, 1956;

(b) a corporation in which not less than forty percent of its capital is held (whether singly or taken together) by:

- the Government; or
- the Reserve Bank of India; or
- a corporation owned by the Government or the Reserve Bank of India. [Section 2(16)]

## Salary or Wage

The "salary or wage" means all remuneration (other than remuneration in respect of over-time work) capable of being expressed in terms of money, which would, if the terms of employment, express or implied, were fulfilled, be payable to an employee in respect of his employment or of work done in such employment and includes dearness allowance (that is to say, all cash payments, by whatever name called, paid to an employee on account of a rise in the cost of living) but does not include:

1. any other allowance which the employee is for the time being entitled to;
2. the value of any house accommodation or of supply of light, water, medical attendance or other amenity or of any service or of any concessional supply of foodgrains or other articles;
3. any travelling concession;
4. any bonus (including incentive, production and attendance bonus);
5. any contribution paid or payable by the employer to any pension fund or provident fund or for the benefit of the employee under any law for the time being in force;
6. any retrenchment compensation or any gratuity or other retirement benefit payable to the employee or any ex-gratia payment made to him;
7. any commission payable to the employee. [Section 2(21)]

The Explanation appended to the Section states that where an employee is given in lieu of the whole or part of the salary or, wage payable to him, free food allowance or free food by his employer, such food allowance or the value of such food shall, for the purpose of this clause, be deemed to form part of the salary or wage of such employee.

The definition is wide enough to cover the payment of retaining allowance and also dearness allowance paid to the workmen. It is nothing but remuneration (Chalthan Vibhag Sahakari Khand Udyog v. Government Labour Officer AIR 1981 SC 905). Subsistence allowance given during suspension is not wages. However lay-off compensation is wages.

## Meaning of Establishment

Section 3 of the Act provides that the word establishment shall include all its departments, undertakings and branches wherever it has so whether situated in the same place or in different places and the same shall be treated as parts of the same establishment for the purpose of computation of bonus under this Act:

Provided that where for any accounting year, a separate balance-sheet and profit and loss account are prepared and maintained in respect of any such department or undertaking or branch then such department, undertaking or branches shall be treated as a separate establishment for the purpose of computation of bonus under this Act for that year, unless such department, or undertaking or branch was, immediately before the commencement of that accounting year treated as part of establishment for the purpose of computation of bonus.

## CALCULATION OF AMOUNT PAYABLE AS BONUS

The Act has laid down a detailed procedure for calculating the amount of bonus payable to employees. First of all, Gross Profit is calculated as per First or Second Schedule. From this Gross Profit, the sums deductible under Section 6 are deducted. To this figure, we add the sum equal to the difference between the direct tax calculated on gross profit for the previous year and direct tax calculated on gross profit arrived at after deducting the bonus paid or payable to the employees. The figure so arrived will be the available surplus. Of this surplus, 67% in case of company (other than a banking company) and 60% in other cases, shall be the "allocable surplus" which is the amount available for payment of bonus to employees. The details of such calculations are given below.

**(i) Computation of gross profits**

As per Section 4, the gross profits derived by an employer from an establishment in respect of any accounting year shall:

(a) in the case of banking company be calculated in the manner specified in the First Schedule.

(b) in any other case, be calculated in the manner specified in the Second Schedule.

**(ii) Deductions from gross profits**

According to Section 6, the sums deductible from gross profits include:

(a) any amount by way of depreciation admissible in accordance with the provisions of Section 32(1) of the Income-tax Act, or in accordance with the provisions of the Agricultural Income-tax Law, as the case may be:

Provided that where an employer has been paying bonus to his employees under a settlement or an award or agreement made before the 29th May, 1965, and subsisting on that date after deducting from the gross profits notional normal depreciation, then, the amount of depreciation to be deducted under this clause shall, at the option of such employer (such option to be exercised once and within one year from that date) continue to be such notional normal depreciation.

What is deductible under Section 6(a), is depreciation admissible in accordance with the provisions of Section 32(1) of the Income- tax Act and not depreciation allowed by the Income-tax Officer in making assessment on the employer.

(b) any amount by way of development rebate, investment allowance, or development allowance which the employer is entitled to deduct from his income under the Income Tax Act.

(c) subject to the provisions of Section 7, any direct tax which the employer is liable to pay for the accounting year in respect of his income, profits and gains during the year.

(d) such further sums as are specified in respect of the employer in the Third Schedule.

**(iii) Calculation direct tax payable by the employer**

Under Section 7, any direct tax payable by the employer for any accounting year shall, subject to the following provisions, be calculated at the rates applicable to the income of the employer for that year, namely:

(a) in calculating such tax no account shall be taken of

(i) any loss incurred by the employer in respect of any previous accounting year and carried forward under any law for the time being in force relating to direct taxes;

(ii) any arrears of depreciation which the employer is entitled to add to the amount of the allowance for depreciation for any following accounting year or years under sub-section (2) of Section 32 of the Income-tax Act;

(iii) any exemption conferred on the employer under Section 84 of the Income-tax Act or of any deduction to which he is entitled under sub-section (1) of Section 101 of that Act, as in force immediately before the commencement of the Finance Act, 1965.

(b) where the employer is a religious or a charitable institution to which the provisions of Section 32 do not apply and the whole or any part of its income is exempt from tax under the Income-tax Act, then, with respect to the income so exempted, such institution shall be treated as if it were a company in which the public are substantially interested within the meaning of that Act;

(c) where the employer is an individual or a Hindu undivided family, the tax payable by such employer under the Income-tax Act shall be calculated on the basis that the income derived by him from the establishment is his only income.

**(iv) Computation of available surplus**

The available surplus in respect of any accounting year shall be the gross profits for that year after deducting therefrom the sums referred to in Section 6.

Provided that the available surplus in respect of the accounting year commencing on any day in the year 1968 and in respect of every subsequent accounting year shall be the aggregate of —

(a) the gross profits for that accounting year after deducting therefrom the sums referred to in Section 6; and

(b) an amount equal to the difference between:

i. the direct tax, calculated in accordance with the provisions of Section 7, in respect of an amount equal to the gross profits of the employer for the immediately preceding accounting year; and

ii. the direct tax calculated in accordance with the provisions of Section 7 in respect of an amount equal to the gross profits of the employer for such preceding accounting year after deducting therefrom the amount of bonus which the employer has paid or is liable to pay to his employees in accordance with the provisions of this Act for that year. (Section 5)

## ELIGIBILITY FOR BONUS AND ITS PAYMENT

**(i) Eligibility for bonus**

Every employee shall be entitled to be paid by his employer in an accounting year, bonus, in accordance with the provisions of this Act, provided he has worked in the establishment for not less than thirty working days in that year. (Section 8)

**(ii) Disqualification for bonus**

An employee shall be disqualified from receiving bonus under this Act, if he is dismissed from service for:

(a) fraud; or

(b) riotous or violent behaviour while on the premises or the establishment; or

(c) theft, misappropriation or sabotage of any property of the establishment. (Section 9)

This provision is based on the recommendations of the Bonus Commission which observed after all bonus can only be shared by those workers who promote the stability and well-being of the industry and not by those who positively display disruptive tendencies. Bonus certainly carries with it obligation of good behaviour".

**(iii) Payment of minimum bonus**

Section 10 states that subject to the other provisions of this Act, every employer shall be bound to pay to every employee in respect of any accounting year a minimum bonus which shall be 8.33 per cent of the salary or wage earned by the employee during the accounting year or one hundred rupees whichever is higher, whether or not the employer has any allocable surplus in the accounting year:

Provided that where an employee has not completed fifteen years of age at the beginning of the accounting year, the provisions of this Section shall have effect in relation to such employee as if for the words one hundred rupees the words sixty rupees were substituted.

Section 10 of the Act is not violative of Articles 19 and 301 of the Constitution. Even if the employer suffers losses during the accounting year, he is bound to pay minimum bonus as prescribed by Section 10 [State v. Sardar Singh Majithia (1979) Lab. I.C.].

**(iv) Maximum bonus**

(1) Where in respect of any accounting year referred to in Section 10, the allocable surplus exceeds the amount of minimum bonus payable to the employees under that Section, the employer shall, in lieu of such minimum bonus, be bound to pay to every employee in respect of that accounting year bonus which shall be an amount in proportion to the salary or wage earned by the employee during the accounting year subject to a maximum of twenty per cent of such salary or wage.

(2) In computing the allocable surplus under this Section, the amount set on or the amount set off under the provisions of Section 15 shall be taken into account in accordance with the provisions of that Section. (Section 11)

**Calculation of bonus with respect to certain employees**

Where the salary or wages of an employee exceeds seven thousand rupees or the minimum wage for the scheduled employment, as fixed by the appropriate Government, whichever is higher per mensem, the bonus payable to such employee under Section 10 or, as the case may be, under section 11, shall be calculated as if his salary or wages were seven thousand rupees or the minimum wage for the scheduled employment, as fixed by the appropriate Government. whichever is higher per mensem. (Section 12)

**(v) Proportionate reduction in bonus in certain cases**

Where an employee has not worked for all the working days in an accounting year, the minimum bonus of one hundred rupees or, as the case may be, of sixty rupees, if such bonus is higher than 8.33 per cent of his salary or wage for the days he had worked in that accounting year, shall be proportionately reduced. (Section 13)

**(vi) Computation of number of working days**

For the purposes of Section 13, an employee shall be deemed to have worked in an establishment in any accounting year also on the days on which:

(a) he has been laid off under an agreement or as permitted by standing orders under the Industrial Employment (Standing Orders) Act, 1946 or under the Industrial Disputes Act, 1947 or under any other law applicable to the establishment;

(b) he has been on leave with salary or wage;

(c) he has been absent due to temporary disablement caused by accident arising out of and in the course of his employment; and

(d) the employee has been on maternity leave with salary or wage, during the accounting year. (Section 14)

**(vii) Set on and set off of allocable surplus**

(1) Where for any accounting year, the allocable surplus exceeds the amount of maximum bonus payable to the employees in the establishment under Section 11, then, the excess shall, subject to a limit of twenty per cent of the total salary or wage of the employees employed in the establishment in that accounting year, be carried forward for being set on in the succeeding accounting year and so on up to and inclusive of the fourth accounting year to be utilized for the purpose of payment of bonus in the manner illustrated in the Fourth Schedule. (Section 15)

(2) Where for any according year, there is no available surplus or the allocable surplus in respect of that year falls short of the amount of minimum bonus payable to the employees in the establishment under Section 10, and there is no amount or sufficient amount carried forward and set on under sub-section (1) which could be utilized for the purpose of payment of the minimum bonus, then, such minimum amount or the deficiency, as the case may be, shall be carried forward for being set off in the succeeding accounting year and so on up to and inclusive of the fourth accounting year in the manner illustrated in the Fourth Schedule.

(3) The principle of set on and set off as illustrated in the Fourth Schedule shall apply to all other cases not covered by sub-section (1) or sub-section (2) for the purpose of payment of bonus under this Act.

(4) Where in any accounting year any amount has been carried forward and set on or set off under this Section, then, in calculating bonus for the succeeding accounting year, the amount of set on or set off carried forward from the earliest accounting year shall first be taken into account.

Apart from the provisions contained in Section 15(1), there is no statutory obligation on an employer to set apart any part of the profits of the previous year for payment of bonus for subsequent years.

**(viii) Adjustment of customary or interim bonus**

Where in any accounting year (a) an employer has paid any puja bonus or other customary bonus to an employee; or (b) an employer has paid a part of the bonus payable under this Act to an employee before the date on which such bonus becomes payable; then, the employer shall be entitled to deduct at the amount of bonus so paid from the amount of bonus payable by him to the employee under this Act in respect of that accounting year and the employee shall be entitled to receive only the balance. (Section 17)

**(ix) Deductions of certain amounts from bonus**

Where in any accounting year (a) an employer has paid any puja bonus or other customary bonus to an employee; or (b) an employer has paid a part of the bonus payable under this Act to an employee before the date on which such bonus becomes payable; then, the employer shall be entitled to deduct at the amount of bonus so paid from the amount of bonus payable by him to the employee under this Act in respect of that accounting year and the employee shall be entitled to receive only the balance. (Section 17)

**(x) Time limit for payment of bonus**

Where in any accounting year, an employee is found guilty of misconduct causing financial loss to the employer, then, it shall be lawful for the employer to deduct the amount of loss from the amount of bonus payable by him to the employee under this Act, in respect of that accounting year only and the employee shall be entitled to receive the balance, if any. (Section 18)

(a) Where there is a dispute regarding payment of bonus pending before any authority under Section 22, all amounts payable to an employee by way of bonus under this Act shall be paid in cash by his employer, within a month from the date from which the award becomes enforceable or the settlement comes into operation, in respect of such dispute;

(b) In any other case, the bonus should be paid within a period of eight months from the close of the accounting year. However, the appropriate Government or such authority as the appropriate Government may specify in this behalf may, upon an application made to it by the employer and for sufficient reasons, by order, extend the said period of 8 months to such further period or periods as it thinks fit, so, however, that the total period so extended shall not in any case exceed two years. (Section 19)

**(xi) Recovery Set on and set off of allocable surplus**

Where any money is due to an employee by way of bonus from his employer under a settlement or an award or agreement, the employee himself or any other person authorised by him in writing in this behalf, or in the case of the death of the employee, his assignee or heirs may, without prejudice to any other mode of recovery, make an application to the appropriate Government for the recovery of the money due to him, and if the appropriate Government or such authority as the appropriate Government may specify in this behalf is satisfied that any money is so due, it shall issue a certificate for that amount to the Collector who shall proceed to recover the same in the same manner as an arrear of land revenue:

If may be noted that every such application shall be made within one year from the date on which the money become due to the employee from the employer. Any such application may be entertained after the expiry of the said period of one year,if the appropriate Governments satisfied that the applicant had sufficient cause for not making the application within the said period.

Explanation: In this Section and in Sections 22, 23, 24 and 25, employee includes a person who is entitled to the payment of bonus under this Act but who is no longer in employment. (Section 21)

Mode of recovery prescribed in Section 21 would be available only if bonus sought to be recovered is under settlement or an award or an agreement. Bonus payable under Bonus Act is not covered by Section 21 (1976-1 Labour Law Journal 511).

## BONUS LINKED WITH PRODUCTION OR PRODUCTIVITY

Section 31A enables the employees and employers to evolve and operate a scheme of bonus payment linked to production or productivity in lieu of bonus based on profits under the general formula enshrined in the Act. However, bonus payments under Section 31A are also subject to the minimum (8.33 per cent) and maximum (20 per cent). In other words a minimum of 8.33 per cent is payable in any case and the maximum cannot exceed 20 per cent. (Section 31-A)

## POWER OF EXEMPTION

If the appropriate Government, having regard to the financial position and other relevant circumstances of any establishment or class of establishments, is of opinion that it will not be in public interest to apply all or any of the provisions of this Act thereto, it may, by notification in the Official Gazette, exempt for such period as may

be specified therein and subject to such conditions as it may think fit to impose, such establishment or class of establishments from all or any of the provisions of this Act. (Section 36)

Government should consider public interest, financial position and whether workers contributed to the loss, before grant of exemption (J.K.Chemicals v. Maharashtra, 1996 III CLA Born. 12).

## PENALTIES

If any person contravenes any of the provisions of this Act or any rule made thereunder; he shall be punishable with imprisonment for a term which may extend to six months, or with fine which may extend to one thousand rupees, or with both. Likewise if any person, to whom a direction is given or a requisition is made under this Act, fails to comply with the direction or requisition, he shall be punishable with imprisonment for a term which may extend to six months, or with fine which may extend to one thousand rupees, or with both. (Section 28)

## OFFENCES BY COMPANIES

If the person committing an offence under this Act is a company, every person who, at the time the offence was committed, was in charge of, and was responsible to, the company for the conduct of business of the company, as well as the company, shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly.

Further, if an offence under this Act has been committed by a company and it is proved that the offence has been committed with the consent or connivance of, or is attributable to any neglect on the part of any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be proceeded against and punished accordingly. (Section 29)

For the purpose of Section 29, 'company' means any body corporate and includes a firm or other association of individuals, and 'director', in relation to a firm, means a partner in the firm.

# Law of Wages

## Unit IV – Equal Remuneration Act, 1976

Article 39 of Constitution of India envisages that the State shall direct its policy, among other things, towards securing that there is equal pay for equal work for both men and women. To give effect to this constitutional provision, the Parliament enacted the Equal Remuneration Act, 1976.

## OBJECT AND SCOPE

The Equal Remuneration Act, 1976:

- provides for payment of equal remuneration to men and women workers for same work or work of similar nature without any discrimination and
- prevents discrimination against women employees while making recruitment for the same work or work of similar nature, or in any condition of service subsequent to recruitment.

The provisions of the Act have been extended to all categories of employment. The Act extends to whole of India.

### Definitions

**"Appropriate Government"** means —

| | |
|---|---|
| the Central Government | in relation to any employment carried<br>- on by or under the authority of the Central Government or<br>- a railway administration, or<br>- in relation to a banking company,<br>- a mine,<br>- oilfield or<br>- major port or<br>- any corporation established by or under a Central Act |
| the State Government | in relation to any other employment |

**"Man"** and **"Woman"** mean male and female human beings, respectively, of any age.

**"Remuneration"** means

- the basic wage or salary, and
- any additional emoluments

whatsoever payable, either in cash or in kind, to a person employed in respect of employment or work done in such employment, if the terms of the contract of employment, express or implied, were fulfilled.

**"Same work or Work of a similar nature"** means work in respect of which the skill, effort and responsibility required are the same, when performed under similar working conditions, by a man or a woman and the differences, if any, between the skill, effort and responsibility required of a man and those required of a woman are not of practical importance in relation to the terms and conditions of employment.

## Duty of employer to pay equal remuneration to men and women workers for same work or work of a similar nature

Section 4 of the Act provides that no employer shall pay to any worker, employed by him in an establishment or employment, remuneration, whether payable in cash or in kind, at rates less favourable than those at which remuneration is paid by him to the workers of the opposite sex in such establishment or employment for performing the same work or work of a similar nature and employer shall not reduce the rate of remuneration of any worker.

## Discrimination not to be made while recruiting men and women

As per section 5 employer while making recruitment for the same work or work of a similar nature, or in any condition of service subsequent to recruitment such as promotions, training or transfer, shall not make any discrimination against women except where the employment of women in such work is prohibited or restricted by or under any law for the time being in force.

However, above mentioned section shall not affect any priority or reservation for Scheduled Castes or Scheduled Tribes, ex-servicemen, retrenched employees or any other class or category of persons in the matter of recruitment to the posts in an establishment or employment.

## Authorities for hearing and deciding claims and complaints

Section 7 of the Act empower the appropriate Government appoint such officers, not below the rank of a Labour Officer, to be the authorities for the purpose of hearing and deciding:

- complaints with regard to the contravention of any provision of the Act;
- claims arising out of non-payment of wages at equal rates to men and women workers for the same work or work of a similar nature;

and define the local limits within which each such authority shall exercise its jurisdiction.

## Maintenance of Registers

As per section 8 it is the duty of every employer, to maintain registers and other documents in relation to the workers employed by him in the prescribed manner.

## Penalty (Section 10)

If any employer: -

a. omits or fails to maintain any register or other document in relation to workers employed by him, or
b. omits or fails to produce any register, muster-roll or other document relating to the employment of workers, or
c. omits or refuses to give any evidence or prevents his agent, servant, or any other person in charge of the establishment, or any worker, from giving evidence, or
d. omits or refuses to give any information,

he shall be punishable with simple imprisonment for a term which may extend to 1 month or with fine which may extend to Rs. 10,000 or with both.

If any employer: -

a. makes any recruitment in contravention of the provisions of this Act; or

b. makes any payment of remuneration at unequal rates to men and women workers for the same work or work of a similar nature; or
c. makes any discrimination between men and women workers in contravention of the provisions of this Act; or
d. omits or fails to carry out any direction made by the appropriate Government,

then he/ she shall be punishable with fine which shall not be less than ten thousand rupees but which may extend to twenty thousand rupees or with imprisonment for a term which shall be not less than three months but which may extend to one year or with both for the first offence, and with imprisonment which may extend to two years for the second and subsequent offences.

# Chapter 18 : Social Security Legislations

## Unit I – Employees' State Insurance Act, 1948

The Employees' State Insurance Act, 1948 provides an integrated need based social insurance scheme that would protect the interest of workers in contingencies such as sickness, maternity, temporary or permanent physical disablement, death due to employment injury resulting in loss of wages or earning capacity. The Act also guarantees reasonably good medical care to workers and their immediate dependents.

## INTRODUCTION

The Employees' State Insurance Act, 1948 provides for certain benefits to employees in case of sickness, maternity and employment injury and also makes provisions for certain other matters in relation thereto. The Act has been amended by the Employees' State Insurance (Amendment) Act, 2010 for enhancing the Social Security Coverage, streamlining the procedure for assessment of dues and for providing better services to the beneficiaries.

The Act extends to the whole of India. The Central Government is empowered to enforce the provisions of the Act by notification in the Official Gazette, to enforce different provisions of the Act on different dates and for different States or for different parts thereof [Section 1(3)].

The Act applies in the first instance to all factories (including factories belonging to the Government) other than seasonal factories [Section 1(4)]. According to the proviso to Section 1(4) of the Act, nothing contained in sub-section (4) of Section 1 shall apply to a factory or establishment belonging to or under the control of the Government whose employees are otherwise in receipt of benefits substantially similar or superior to the benefits provided under the Act.

Section 1(5) of the Act empowers the appropriate Government to extend any of the provisions of the Act to any other establishment or class of establishments, industrial, commercial, agricultural or otherwise after giving one month's notice in the Official Gazettee. However, this can be done by the appropriate Government, only in consultation with the Employees' State Insurance Corporation set up under the Act and, where the appropriate Government is a State Government, it can extend the provisions of the Act with the approval of the Central Government.

Under these enacting provisions, the Act has been extended by many State Governments to shops, hotels, restaurants, cinemas, including preview theatres, newspaper establishments, road transport undertakings, etc., employing 20 or more persons. It is not sufficient that 20 persons are employed in the shop. They should be employee as per Section 2(9) of the Act, getting the wages prescribed therein (ESIC v. M.M. Suri & Associates Pvt. Ltd., 1999 LAB IC SC 956). According to the proviso to sub-section (5) of Section 1 where the provisions of the Act have been brought into force in any part of a State, the said provisions shall stand extended to any such establishment or class of establishment within that part, if the provisions have already been extended to similar establishment or class of establishments in another part of that State.

It may be noted that a factory or an establishment to which the Act applies shall continue to be governed by this Act even if the number of persons employed therein at any time falls below the limit specified by or under the Act or the manufacturing process therein ceases to be carried on with the aid of power. [Section 1(6)]

## IMPORTANT DEFINITIONS

### I. Appropriate Government

"Appropriate Government" means in respect of establishments under the control of the Central Government or a railway administration or a major port or a mine or oil-field; the Central Government, and in all other cases, the State Government. [Section 2(1)]

### II. Confinement

"Confinement" means labour resulting in the issue of a living child or labour after 26 weeks of pregnancy resulting in the issue of child whether alive or dead. [Section 2(3)]

### III. Contribution

"Contribution" means the sum of money payable to the Corporation by the principal employer in respect of an employees and includes any amount payable by or on behalf of the employee in accordance with the provisions of this Act. [Section 2(4)]

### IV. Dependent

"Dependent" under Section 2(6A) of the Act (as amended by the Employees' State Insurance (Amendment) Act, 2010) means any of the following relatives of a deceased insured person namely:

(i) a widow, a legitimate or adopted son who has not attained the age of twenty-five years,, an unmarried legitimate or adopted daughter,

a widowed mother,

(ii) if wholly dependent on the earnings of the insured person at the time of his death, a legitimate or adopted son or daughter who has attained the age of 25 years and is infirm;

(iii) if wholly or in part dependent on the earnings of the insured person at the time his death:

(a) a parent other than a widowed mother,

(b) a minor illegitimate son, an unmarried illegitimate daughter or a daughter legitimate or adopted or illegitimate if married and minor or if widowed and a minor,

(c) a minor brother or an unmarried sister or a widowed sister if a minor,

(d) a widowed daughter-in-law,

(e) a minor child of a pre-deceased son,

(f) a minor child of a pre-deceased daughter where no parent of the child is alive or,

(g) a paternal grand parent if no parent of the insured person is alive.

## V. Employment Injury

It means a personal injury to an employee caused by accident or an occupational disease arising out of and in the course of his employment, being an insurable employment, whether the accident occurs or the occupational disease is contracted within or outside the territorial limits of India. [Section 2(8)]

It is well settled that an employment injury need not necessarily be confined to any injury sustained by a person within the premises or the concern where a person works. Whether in a particular case the theory of notional extension of employment would take in the time and place of accident so as to bring it within an employment injury, will have to depend on the assessment of several factors. There should be a nexus between the circumstances of the accident and the employment. On facts no case could be an authority for another case, since there would necessarily be some differences between the two cases. Therefore, each case has to be decided on its own facts. It is sufficient if it is proved, that the injury to the employee was caused by an accident arising out of and in the course of employment no matter when and where it occurred.

There is not even a geographical limitation.

In E.S.I. Corpn. Indore v. Babulal, 1982 Lab. I.C. 468, the M.P. High Court held that injury arose out of employment where a workman attending duty in spite of threats by persons giving call for strike and was assaulted by them while returning after his duty was over. A worker was injured while knocking the belt of the moving pulley, though the injury caused was to his negligence, yet such an injury amounts to an employment injury (Jayanthilal Dhanji Co. v. E.S.I.C., AIR AP 210).

The word injury does not mean only visible injury in the form of some wound. Such a narrow interpretation would be inconsistent with the purposes of the Act which provides certain benefits in case of sickness, maternity and employment injury (Shyam Devi v. E.S.I.C., AIR 1964 AII. 42).

## VI. Employee

"Employee" according to Section 2(9) as amended by the Employees' State Insurance (Amendment) Act, 2010 means any person employed for wages in connection with the work of a factory or establishment to which this Act applies and:

(i) who is directly employed by the principal employer on any work of, or incidental or preliminary to or connected with the work of the factory or establishment, whether such work is done by employee in the factory or establishment; or elsewhere, or

(ii) who is employed by or through a immediate employer on the premises of the factory or establishment or under the supervision of the principal employer or his agent, on work which is ordinarily part of the work of the factory or establishment or which is preliminary to the work carried on in or incidental to the purpose of the factory or establishment; or

(iii) whose services are temporarily lent or let on hire to the principal employer by the person with whom the person, whose services are so lent or let on hire, has entered into a contract of service;

and includes any person employed for wages on any work connected with the administration of the factory or establishment or any part, department or branch thereof, or with the purchase of raw materials of, or the distribution or sale of the product of the factory or establishment; or any person engaged as an apprentice, not being an apprentice engaged under Apprentices Act, 1961 and includes such person engaged as apprentice whose training period is extended to any length of time, ; but does not include:

(a) any member of the Indian Naval, Military or Air Forces; or

(b) any person so employed whose wages (excluding remuneration for overtime work) exceed such wages as may be prescribed by the Central Government.

Provided that an employee whose wages (excluding remuneration for overtime work) exceed such wages as may be prescribed by the Central Government at any time after (and not before) the beginning of the contribution period shall continue to be an employee until the end of that period. The Central Government has since prescribed the wage limit for coverage of an employee under Section 2(9) of the Act as Rs. 21,000 per month. Further, it is provided that an employee whose wages (excluding remuneration for overtime work) exceed Rs. 21,000 a month at any time after and not before the beginning of the contribution period, shall continue to be an employee until the end of the period.

## VII. Exempted Employee

"Exempted Employee" means an employee who is not liable under this Act to pay the employees contribution.

## VIII. Principal Employer

"Principal Employer" means the following:

(i) in a factory, owner or occupier of the factory and includes the managing agent of such owner or occupier, the legal representative of a deceased owner or occupier and where a person has been named as the manager of the factory under the Factories Act, 1948, the person so named;

(ii) in any establishment under the control of any department of any Government in India, the authority appointed by such Government in this behalf or where no authority is so appointed the head of the Department;

(iii) in any other establishment, any person responsible for the supervision and control of the establishment. [Section 2(17)]

## IX. Family

"Family" under Section 2(11) as amended by the Employees' State Insurance (Amendment) Act, 2010 means all or any of the following relatives of an insured person, namely:

i. a spouse;

ii. a minor legitimate or adopted child dependent upon the insured person;

iii. a child who is wholly dependent on the earnings of the insured person and who is:

- receiving education, till he or she attains the age of twenty-one years;
- an unmarried daughter;

iv. a child who is infirm by reason of any physical or mental abnormality or injury and is wholly dependent on the earnings of the insured person, so long as the infirmity continues;

v. dependent parents whose income from all sources does not exceed such income as may be prescribed by the Central Government;

vi. In case the insured person is unmarried and his or her parents are not alive, a minor brother or sister wholly dependant upon the earnings of the insured person.

## X. Factory

The definition of the factory as amended by the Employees' State Insurance (Amendment) Act, 2010 is as follows:

"Factory" means any premises including the precincts thereof whereon ten or more persons are employed or were employed on any day of the preceding twelve months, and in any part of which a manufacturing process is being carried on or is ordinarily so carried on, but does not including a mine subject to the operation of the Mines Act, 1952 or a railway running shed.

It may be noted that the terms manufacturing process, occupier and power, shall have the meaning assigned to them in the Factories Act, 1948. [Section 2(12)]

## XI. Immediate Employer

"Immediate Employer" means a person, in relation to employees employed by or through him, who has undertaken the execution on the premises of a factory or an establishment to which this Act applies or under the supervision of principal employer or his agent, of the whole or any part of any work which is ordinarily part of the work of the factory or establishment of the principal employer or is preliminary to the work carried on, in or incidental to the purpose of any such factory or establishment, and includes a person by whom the services of an employee who has entered into a contract of service with him are temporarily lent or let on hire to the principal employer and includes a contractor. [Section 2(13A)] It would not be necessary that the work undertaken by immediate employer should be in the premises where the factory of principal employer is situated (1997-11 LU 31 Pat.).

## XII. Insurable Employment

It means an employment in factory or establishment to which the Act applies. [Section 2(13A)]

### XIII. Insured person

It means a person who is or was an employee in respect of whom contributions are, or were payable under the Act and who is by reason thereof entitled to any of the benefits provided under the Act. [Section 2(14)]

### XIV. Permanent Partial Disablement

It means such disablement of a permanent nature, as reduced the earning capacity of an employee in every employment which he was capable of undertaking at the time of the accident resulting in the disablement:

Provided that every injury specified in Part II of the Second Schedule to the Act shall be deemed to result in permanent partial disablement. [Section 2(15A)]

### XV. Permanent Total Disablement

It means such disablement of a permanent nature as incapacitates an employee for all work which he was capable of performing at the time of the accident resulting in such disablement:

Provided that permanent total disablement shall be deemed to result from every injury specified in Part-I of the Second Schedule to the Act or from any combination of injuries specified in Part-II thereof, where the aggregate percentage of the loss of earning capacity, as specified in the said Part-II against those injuries, amounts to one hundred per cent or more. [Section 2(15B)]

### XVI. Seasonal Factory

It means a factory which is exclusively engaged in one or more of the following manufacturing processes namely, cotton ginning, cotton or jute pressing, decortication of groundnuts, the manufacture of coffee, indigo, lac, rubber, sugar (including gur) or tea or any manufacturing process which is incidental to or connected with any of the aforesaid processes and includes a factory which is engaged for a period not exceeding seven months in a year:

(a) in any process of blending, packing or repacking of tea or coffee; or

(b) in such other manufacturing process as the Central Government may by notification in the Official Gazette, specify. [Section 2(19A)]

### XVII. Sickness

It means a condition which requires medical treatment and attendance and necessitates, abstention from work on medical grounds. [Section 2(20)]

### XVIII. Temporary Disablement

It means a condition resulting from an employment injury which requires medical treatment and renders an employee as a result of such injury, temporarily incapable of doing the work which he was doing prior to or at the time of injury. [Section 2(21)]

## XIX. Wages

"Wages" means all remuneration paid or payable in cash to an employee if the terms of the contract of employment, express or implied, were fulfilled and includes any payment to an employee in respect of any period of authorised leave, lock-out, strike which is not illegal or lay-off and other additional remuneration if any, paid at intervals not exceeding two months but does not include:

(a) any contribution paid by the employer to any pension fund or provident fund, or under this Act;

(b) any travelling allowance or the value of any travelling concession;

(c) any sum paid to the person employed to defray special expenses entailed on him by the nature of his employment, or

(d) any gratuity payable on discharge. [Section 2(22)]

Wages include other additional remuneration paid at intervals not exceeding two months wages. It is question of fact in each case whether sales commission and incentive are payable at intervals not exceeding two months (Handloom House Ernakulam v. Reg. Director, ESIC, 1999 CLA 34 SC 10). Travelling allowance paid to employees is to defray special expenses entitled on him by nature of his employment. It does not form part of wages as defined under Section 2(22) of the E.S.I. Act. Therefore, employer is not liable to pay contribution on travelling allowance. [S. Ganesan v. The Regional Director, ESI Corporation, Madras, 2004 Lab.I.C 1147]

## REGISTRATION OF FACTORIES AND ESTABLISHMENTS UNDER THIS ACT

Section 2A of the Act lays down that every factory or establishment to which this Act applies shall be registered within such time and in such manner as may be specified in the regulations made in this behalf.

## EMPLOYEES' STATE INSURANCE

Section 38 of the Act makes compulsory that subject to the provisions of the Act all the employees in factories or establishments to which this Act applies shall be insured in the manner provided by this Act. Such insured persons shall pay contributions towards Insurance Fund through their employers who will also pay their own contribution. Such insured persons are entitled to get certain benefits from that fund which shall be administered by the Corporation. Any dispute will be settled by the Employees' Insurance Court.

## ADMINISTRATION OF EMPLOYEES' STATE INSURANCE SCHEME

For the administration of the scheme of Employees' State Insurance in accordance with the provisions of this Act, the Employees' State Insurance Corporation Standing Committee and Medical Benefit Council have been constituted. Further, ESI Fund has been created which is held and administered by ESI Corporation through its executive committee called Standing Committee with the assistance, advice and expertise of Medical Council, etc. and Regional and Local Boards and Committees.

## EMPLOYEES' STATE INSURANCE CORPORATION

Section 3 of this Act provides for the establishment of Employees' State Insurance Corporation by the Central Government for administration of the Employees' State Insurance Scheme in accordance with the provisions of Act. Such Corporation shall be body corporate having perpetual succession and a common seal and shall sue and be sued by the said name.

### Constitution

The Central Government appoints a chairman, a vice-chairman and other members representing interests of employers, employees, state governments/union territories and medical profession. Three members of the Parliament and the Director General of the Corporation are its ex-officio members. [Section 4]

### Powers and duties of the Corporation

Section 19 empowers the Corporation, to promote (in addition to the scheme of benefits specified in the Act), measures for the improvement of the health and welfare of insured persons and for the rehabilitation and re- employment of insured persons who have been disabled or injured and incur in respect of such measures expenditure from the funds of the Corporation within such limits as may be prescribed by the Central Government.

Section 29 empowers the Corporation

a) to acquire and hold property both movable and immovable, sell or otherwise transfer the said property;
b) it can invest and reinvest any moneys which are not immediately required for expenses and or realise such investments;
c) it can raise loans and discharge such loans with the previous sanction of Central Government;
d) it may constitute for the benefit of its staff or any class of them such provident or other benefit fund as it may think fit. However, the powers under Section 29 can be exercised subject to such conditions as may be prescribed by the Central Government.

### Appointment of Regional Boards, etc.

The Corporation may appoint Regional Boards, Local Committees and Regional and Local Medical Benefit Councils in such areas and in such manner, and delegate to them such powers and functions, as may be provided by the regulations. (Section 25)

## WINGS OF THE CORPORATION

The Corporation to discharge its functions efficiently, has been provided with two wings:

### Standing Committee

The Act provides for the constitution of a Standing Committee under Section 8 from amongst its members.

### Power of the Standing Committee

The Standing Committee has to administer affairs of the Corporation and may exercise any of the powers and perform any of the functions of the Corporation subject to the general superintendence and control of the Corporation. The standing Committee acts as an executive body for administration of Employees State Insurance Corporation.

### Medical Benefit Council

Section 10 empowers the Central Government to constitute a Medical Benefit Council. Section 22 determines the duties of the Medical Benefit Council stating that the Council shall:

a. advise the Corporation and the Standing Committee on matters relating to administration of medical benefit, the certification for purposes of the grant of benefit and other connected matters;

b. have such powers and duties of investigation as may be prescribed in relation to complaints against medical practitioners in connection with medical treatment and attendance; and

c. perform such other duties in connection with medical treatment and attendance as may be specified in the regulations.

## EMPLOYEES' STATE INSURANCE FUND

### Creation of Fund

Section 26 of the Act provides that all contributions paid under this Act and all other moneys received on behalf of the Corporation shall be paid into a Fund called the Employees' State Insurance Fund which shall be held and administered by the Corporation for the purposes of this Act. The Corporation may accept grants, gifts, donations from the Central or State Governments, local authority, or any individual or body whether incorporated or not, for all, or any of the purposes of this Act. A Bank account in the name of Employees' State Insurance Fund shall be opened with the Reserve Bank of India or any other Bank approved by the Central Government. Such account shall be operated on by such officers who are authorised by the Standing Committee with the approval of the Corporation.

### Purposes for which the Fund may be expended

Section 28 provides that Fund shall be expended only for the following purposes:

i. payment of benefits and provisions of medical treatment and attendance to insured persons and, where the medical benefit is extended to their families, in accordance with the provisions of this Act and defraying the charge, and costs in connection therewith;

ii. payment of fees and allowances to members of the Corporation, the Standing Committee and Medical Benefit Council, the Regional Boards, Local Committees and Regional and Local Medical Benefit Councils;

iii. payment of salaries, leave and joining time allowances, travelling and compensatory allowances, gratuities and compassionate allowances, pensions, contributions to provident or other benefit fund of officers and servants of the Corporation and meeting the expenditure in respect of officers and other services set up for the purpose of giving effect to the provisions of this Act;

iv. establishment and maintenance of hospitals, dispensaries and other institutions and the provisions of medical and other ancillary services for the benefit of insured persons and where the medical benefit is extended to their families, their families;

v. payment of contribution to any State Government, local authority or any private body or individual towards the cost of medical treatment and attendance provided to insured persons and where the medical benefit is extended to their families, their families

including the cost of any building and equipment, in accordance with any agreement entered into by the Corporation;

vi. defraying the cost (including all expenses) of auditing the accounts of the Corporation and of the valuation of the assets and liabilities;

vii. defraying the cost (including all expenses) of Employees Insurance Courts set up under this Act;

viii. payment of any sums under any contract entered into for the purposes of this Act by the Corporation or the Standing Committee or by any officer duly authorised by the Corporation or the Standing Committee in that behalf;

ix. payment of sums under any decree, order or award, of any court or tribunal against the Corporation or any of its officers or servants for any act done in execution of his duty or under a compromise or settlement of any suit or any other legal proceedings or claims instituted or made against the Corporation;

x. defraying the cost and other charges of instituting or defending any civil or criminal proceedings arising out of any action taken under this Act;

xi. defraying expenditure within the limits prescribed, on measure for the improvement of the health and welfare of insured persons and for the rehabilitation and re-employment of insured persons who have been disabled or injured; and

xii. such other purposes as may be authorised by the Corporation with the previous approval of the Central Government.

## CONTRIBUTIONS

The contributions have to be paid at such rates as may be prescribed by the Central Government. The wage period in relation to an employee shall be the unit in respect of which all contributions shall be payable. The contributions payable in respect of each wage period shall ordinarily fall due on the last day of the wage period and where an employee is employed for part of the wage period, or is employed under two or more employers during the same wage period, the contributions shall fall due on such days as may be specified in the regulations.

### Principal employer to pay contributions in the first instance

According to Section 40 of the Act, it is incumbent upon the principal employer to pay in respect of every employee whether directly employed by him or by or through an immediate employer, both the employers contributions and the employees contribution. However, he can recover from the employee (not being an exempted employee) the employees contribution by deduction from his wages and not otherwise. Further Section 40 provides that the principal employer has to bear the expenses of remitting the contributions to that Corporation.

According to Section 39(5) of the Act, if any contribution payable is not paid by the principal employer on the date on which such contribution has become due, he shall be liable to pay simple interest at the rate of 12 per cent per annum or at such higher rate as may be specified in the regulations, till the date of its actual payment. However, according to proviso to sub-section (5) of Section 39, higher interest specified in the regulations should not exceed the lending rate of interest charged by any scheduled bank. It may be noted that any interest recoverable as stated above may be recovered as an arrear of land revenue or under newly introduced Sections 45-C to 45-1 of the Act.

## Recovery of contribution from immediate employer

According to Section 41, principal employer who has paid contribution in respect of an employee employed by or through an immediate employer is entitled to recover the amount of contribution so paid (both employers and employees contribution) from the immediate employer either by deduction from any amount payable to him by the principal employer under any contract or as a debt payable by the immediate employer. However the immediate employer is entitled to recover the employees contribution from the employee employed by or through him by deduction from wages and not otherwise. The immediate employer is required to maintain a register of employees employed by or through him as provided in the Regulations and submit the same to the principal employer before the settlement of any amount payable. He is not required to have separate account with ESI (LAB IC 1999 Kar 1369).

## Method of payment of contribution

Section 43 provides for the Corporation to make regulations for payment and collection of contribution payable under this Act and such regulations may provide for:

a. the manner and time for payment of contribution;
b. the payment of contributions by means of adhesive or other stamps affixed to or impressed upon books, cards or otherwise and regulating the manner, times and conditions in, at and under which, such stamps are to be affixed or impressed;
c. the date by which evidence of contributions having been paid is to be received by the Corporation;
d. the entry in or upon books or cards or particulars of contribution paid and benefits distributed in the case of the insured persons to whom such books or card relate; and
e. the issue, sale, custody, production, inspection and delivery of books or cards and the replacement of books or cards which have been, lost, destroyed or defaced.

## BENEFITS

Under Section 46 of the Act, the insured persons, their dependants are entitled to the following benefits on prescribed scale:

(a) periodical payments in case of sickness certified by medical practitioner;
(b) periodical payments to an insured workman in case of confinement or miscarriage or sickness arising out of pregnancy, confinement;
(c) periodical payment to an insured person suffering from disablement as a result of employment injury;
(d) periodical payment to dependants of insured person;
(e) medical treatment and attendance on insured person;
(f) payment of funeral expenses on the death of insured person at the prescribed rate of.

### General provisions relating to Benefits

Right to receive benefits is not transferable or assignable. When a person receives benefits under this Act, he is not entitled to receive benefits under any other enactment.

An insured person is not entitled to receive for the same period more than one benefit, e.g. benefit of sickness cannot be combined with benefit of maternity or disablement, etc.

## EMPLOYEES' INSURANCE COURT (E.I. COURT)

### Constitution

Section 74 of the Act provides that the State Government shall by notification in the Official Gazette constitute an Employees' Insurance Court for such local area as may be specified in the notification. The Court shall consist of such number of judges as the State Government may think fit. Any person who is or has been judicial officer or is a legal practitioner of 5 years standing shall be qualified to be a judge of E.I. Court. The State Government may appoint the same Court for two or more local areas or Mo or more Courts for the same local area and may regulate the distribution of business between them.

### Matters to be decided by E.I. Court

**(i) Adjudication of disputes**

The Employees' Insurance Court has jurisdiction to adjudicate disputes, namely, whether any person is an employee under the Act, rate of wages/contribution, as to who is or was the principal employer, right of a person to any benefit under the Act.

**(ii) Adjudication of claims**

The El Court also has jurisdiction to decide claims for recovery of contribution from principal employer or immediate employer, action for failure or negligence to pay contribution, claim for recovery of any benefit admissible under the Act.

Proceedings in both the above cases can be initiated by filing application in the prescribed form by the employee or his dependent or employer or the corporation depending who has cause of action.

No Civil Court has power to decide the matters falling within the purview/ jurisdiction of E.I. Court.

## EXEMPTIONS

The appropriate Government may exempt any factory/establishment from the purview of this Act, as well as any person or class of persons employed in any factory/establishment, provided the employees employed therein are in receipt of benefits superior to the benefits under the Act. Such exemption is initially given for one year and may be extended from time to time. The applicant has to submit application justifying exemption with full details and satisfy the concerned Government.

# Social Security Legislations

# Unit II – Employees' Provident Funds and Miscellaneous Provisions Act, 1952

The Employees' Provident Funds and Miscellaneous Provisions Act, 1952 provides for the institution of provident funds, pension fund and deposit linked insurance fund for employees in factories and other establishments. It extends to the whole of India except the State of Jammu and Kashmir.

## INTRODUCTION

Provident Fund schemes for the benefit of the employees had been introduced by some organisations even when there was no legislation requiring them to do so. Such schemes were, however, very few in number and they covered only limited classes/groups of employees. In 1952, the Employees Provident Funds Act was enacted to provide institution of Provident Fund for workers in six specified industries with provision for gradual extension of the Act to other industries/classes of establishments. The Act extends to whole of India except Jammu and Kashmir. The term pay includes basic wages with dearness allowance, retaining allowance (if any), and cash value of food concession.

The following three schemes have been framed under the Act by the Central Government:

(a) The Employees' Provident Fund Schemes, 1952;

(b) The Employees' Pension Scheme, 1995; and

(c) The Employees' Deposit-Linked Insurance Scheme; 1976.

The three schemes mentioned above confer significant social security benefits on workers and their dependents.

## APPLICATION OF THE ACT

According to Section 1(3), the Act, subject to the provisions of Section 16, applies:

(a) to every establishment which is a factory engaged in any industry specified in Schedule I and in which twenty or more persons are employed; and

(b) to any other establishment employing twenty or more persons or class of such establishments which the Central Government may, by notification in the Official Gazette, specify in this behalf:

Provided that the Central Government may, after giving not less than two months notice of its intention to do so by notification in the Official Gazette, apply the provisions of this Act to any establishment employing such number of persons less than twenty as may be specified in the notification.

The Central Government can extend the provisions of the Act to any establishment [including the co-operative society to which under Section 16(1) the provisions of the Act are not applicable by notification in Official Gazette when the employer and the majority of employees in relation to any establishment have agreed that the provisions of this Act should be made applicable to them [Section 1(4)].

However, before notification is made, parties can opt out of such an agreement (1996 20 CLA 25 Born.). Once an establishment falls within the purview of the Act, it shall continue to be governed by this Act notwithstanding that the number of persons employed therein at any time falls below twenty. [Section 1(5)]

Where an establishment to which this Act applied was divided among the partners, the Act would continue to apply to the part of each ex-partner even if the number of persons employed in each part is less than twenty (1986 2 LU 137). Where as a result of real and bona fide partition among the owners, an establishment was disrupted and separate and distinct establishments come into existence, allottees with no regular employee, cannot be saddled with liability to pay minimum administrative charges as before (1993 I LLN 698). For compliance with the Act and the scheme, for an establishment there should be an employer and one or more employees are required to be in existence atleast. When there is not even one employee, it would be difficult to contend that the Act continues to apply to the establishment (1998 LU I Kar. 780).

The constitutional validity of this Act was challenged on the ground of discrimination and excessive delegation. It was held that the law lays down a rule which is applicable to all the factories or establishments similarly placed. It makes a reasonable classification without making any discrimination between factories placed in the same class or group (Delhi Cloth and General Mills v. R.P.F. Commissioner A.I.R. 1961 AII. 309).

The liability to contribute to the provident fund is created the moment the Scheme is applied to a particular establishment.

Section 1(3)(b) empowers the Central Government to apply the Act to trading or commercial establishments whether, such establishments are factories or not.

## Non-applicability of the Act to certain establishments

Section 16(1) of the Act provides that the Act shall not apply to certain establishments as stated thereunder. Such establishments include

a. establishments registered under the Co-operative Societies Act, 1912, or under any other law for the time being in force in any State relating to co-operative societies, employing less than 50 persons and working without the aid of power; or
b. to any other establishment belonging to or under the control of the Central Government or a State Government and whose employees are entitled to the benefit of contributory provident fund or old age pension in accordance with any scheme or rule framed by the Central Government or the State Government governing such benefits; or
c. to any other establishment set up under any Central, Provincial or State Act and whose employees are entitled to the benefits of contributory provident fund or old age pension in accordance with any scheme or rule framed under that Act governing such benefits.

According to Section 16(2), if the Central Government is of opinion that having regard to the financial position of any class of establishments or other circumstances of the case, it is necessary or expedient so to do, it may, by notification in the Official Gazette, and subject to such conditions as may be specified in the notification, exempt that class of establishments from the operation of this Act for such period as may be specified in the notification.

The date of establishment of a factory is the date when the factory starts its manufacturing process. A change in the ownership does not shift the date of establishment. A mere change in the partnership deed, does not mean that a new business has come into existence for the purpose of Section 16(1) [P.G. Textile Mills v. Union of India (1976) 1 LU 312].

## IMPORTANT DEFINITIONS

To understand the meaning of different Sections and provisions thereto, it is necessary to know the meaning of important expressions used therein. Section 2 of the Act explains such expressions which are given below:

### I. Appropriate Government

"Appropriate Government" means:

(i) in relation to those establishments belonging to or under the control of the Central Government or in relation to an establishment connected with a railway company, a major port, a mine or an oil field or a controlled industry, or in relation to an establishment having departments or branches in more than one State, the Central Government; and

(ii) in relation to any other establishment, the State Government. [Section 2(a)]

### II. Basic Wages

"Basic Wages" means all emoluments which are earned by an employee while on duty or on leave or on holiday with wages in either case in accordance with the terms of the contract of employment and which are paid or payable in cash to him, but does not include:

(i) the cash value of any food concession;

(ii) any dearness allowance (that is to say, all cash payments by whatever name called paid to an employee on account of a rise in the cost of living), house- rent allowance, overtime allowance, bonus, commission or any other similar allowance payable to the employee in respect of his employment or of work done in such employment;

(iii) any presents made by the employer. [Section 2(b)]

### III. Contribution

"Contribution" means a contribution payable in respect of a member under a Scheme or the contribution payable in respect of an employee to whom the Insurance Scheme applies. [Section 2(c)]

### IV. Controlled Industry

"Controlled Industry" means any industry the control of which by the Union has been declared by the Central Act to be expedient in the public interest. [Section 2(d)]

### V. Employer

"Employer" means

(i) in relation to an establishment which is a factory, the owner or occupier of the factory, including the agent of such owner or occupier, the legal representative

of a deceased owner or occupier and where a person has been named as a manager of the factory under clause (f) of sub-section (1) of Section 7 of the Factories Act, 1948, the person so named; and

(ii) in relation to any other establishment, the person who or the authority which, has the ultimate control over the affairs of the establishment, and where the said affairs are entrusted to a manager, managing director, or managing agent, such manager, managing director or managing agent. [Section 2(e)]

## VI. Employee

"Employee" means any person who is employed for wages in any kind of work, manual or otherwise, in or in connection with the work of an establishment and who gets his wages directly or indirectly from the employer and includes any person

(i) employed by or through a contractor in or in connection with the work of the establishment;

(ii) engaged as an apprentice, not being an apprentice engaged under Apprentices Act, 1961 or under the standing orders of the establishment. [Section 2(f)]

The definition is very wide in its scope and covers persons employed for clerical work or other office work in connection with the factory or establishment. The inclusive part of the definition makes it clear that even if a person has been employed through a contract in or in connection with the work of the establishment, he would yet fall within the description of employee within the meaning of the Act.

The dominant factor in the definition of 'employee in Section 2(f) of the Act is that a person should be employed in or in connection with the work of the establishment. Sons being paid wages are employees (Goverdhanlal v. REPC 1994 II LLN 1354). In case of doubt whether a particular person is an employee or not, both the parties should be heard by the Commissioner before deciding the issue (1976-11 Labour Law Journal, 309).

The definition of employee in Section 2(f) of the Act is comprehensive enough to cover the workers employed directly or indirectly and therefore, wherever the word employee is used in this Act, it should be understood to be within the meaning of this definition (Malwa Vanaspati and Chemical Co. Ltd. v. Regional Provident Fund Commissioner, M.P. Region, Indore, 1976-I Labour Law Journal 307).

The definition of "employee", includes a part-time employee, who is engaged for any work in the establishment, a sweeper working twice or thrice in a week, a night watchman keeping watch on the shops in the locality, a gardener working for ten days in a month, etc. (Railway Employees Co-operative Banking Society Ltd. v. The Union of India, 1980 Lab. IC 1212). The Government of India, by certain notification extended the application of Act and EPF scheme to beedi industry. It was held that the workers engaged by beedi manufacturers directly or through contractors for rolling beedi at home subject to rejection of defective beedies by manufacturers, were employees (1986 1 SCC 32). But working partners drawing salaries or other allowances are not employees. When members of cooperative society do work in connection with that of society and when wages are paid to them, there would be employer-employee relationship and such member-workers would be covered under the definition (1998 LU I Mad. 827).

### VII. Exemption Employee

It means an employee to whom a Scheme or the Insurance Scheme as the case may be would, but for the exemption granted under Section 17, have applied. [Section 2(ff)]

### VIII. Exemption Establishment

It means an establishment in respect of which an exemption has been granted under Section 17 from the operation of all or any of the provisions of any Scheme or the Insurance Scheme as the case may be whether such exemption has been granted to the establishment as such or to any person or class of persons employed therein. [Section 2(fff)]

### IX. Factory

It means any premises including the precincts thereof, in any part of which a manufacturing process is being carried on or ordinarily so carried on, whether with the aid of power or without the aid of power. [Section 2(g)]

### X. Fund

It means Provident Fund established under the Scheme. [Section 2(h)]

### XI. Industry

It means any industry specified in Schedule I, and includes any other industry added to the Schedule by notification under Section 4. [Section 2(i)]

### XII. Insurance Fund

It means the Deposit-Linked Insurance Fund established under sub-section (2) of Section 6-C. [Section 2(i-a)]

### XIII. Insurance Scheme

It means the Employees Deposit-Linked Insurance Scheme framed under sub-section (1) of Section 6-C. [Section 2(i-b)]

### XIV. Manufacture or Manufacturing Process

It means any process for making, altering, repairing, ornamenting, finishing, packing, oiling, washing, cleaning, breaking up, demolishing or otherwise treating or adapting any article or substance with a view to its use, sale, transport, delivery or disposal. [Section 2(i-c)]

### XV. Member

"Member" means a member of the Fund. [Section 2(j)]

### XVI. Occupier of a Factory

It means the person, who has ultimate control over the affairs of the factory, and where the said affairs are entrusted to a managing agent, such agent shall be deemed to be the occupier of the factory. [Section 2(k)]

### XVII. Pension Fund

"Pension Fund" means the Employees Pension Fund established under sub-section (2) of Section 6A. [Section 2(kA)]

### XVIII. Pension Scheme

"Pension Scheme" means the Employees Pension Scheme framed under sub-section (1) of Section 6A. [Section 2(kB)]

### XIX. Scheme

It means the Employees' Provident Fund Scheme framed under Section S. [Section 2(I)]

### XX. Superannuation

"Superannuation", in relation to an employee, who is the member of the Pension Scheme, means the attainment, by the said employee, of the age of 58 years. [Section 2(II)]

### Different departments or branches of an establishment

Where an establishment consists of different departments or branches situated in the same place or in different places, all such departments or branches shall be treated as parts of the same establishment. (Section 2A)

## SCHEMES UNDER THE ACT

In exercise of the powers conferred under the Act, the Central Government has framed the following three schemes:

### (A) Employees Provident Fund Scheme

The Central Government has framed a Scheme called Employees Provident Fund Scheme. The Fund vests in and is administered by the Central Board constituted under Section 5A.

### Administration of the Fund

(a) Board of Trustees or Central Board: Section 5A provides for the administration of the Fund. The Central Government may by notification in the Official Gazette constitute with effect from such date as may be specified therein, a Board of Trustees, for the territories to which this Act extends.

The Employees Provident Fund Scheme contains provisions regarding the terms and conditions subject to which a member of the Central Board may be appointed and of procedure of the meetings of the Central Board. The Scheme also lays down the manner in which the Board shall administer the funds vested in it however subject to the provisions of Section 6AA and 6C of the Act. The Board also performs functions under the Family Pension Scheme and the Insurance Scheme.

### Class of employees entitled and required to join Provident Fund

Every employee employed in or in connection with the work of a factory or other establishment to which this scheme applies, other than an excluded employee, shall be entitled and required to become a member of the fund from the date of joining the factory or establishment.

The term "excluded employee" has been defined in para 2(f) of the Employees' Provident Fund Scheme, 1952 as follows:

'Excluded employee' means:

(i) an employee who, having been a member of the Fund, withdraw the full amount of his accumulations in the Fund under clause (a) or (c) of sub-paragraph 69;

(ii) an employee whose pay at the time be is otherwise entitled to become a member of the Fund, exceeds fifteen thousand rupees per month.

Explanation: "Pay" includes basic wages with dearness allowance retaining allowance (if any) and cash value of food concession admissible thereon.

(iii) An apprentice.

Explanation: An apprentice means a person who, according to the certified standing orders applicable to the factory or establishment is an apprentice, or who is declared to be an apprentice by the authority specified in this behalf by the appropriate Government.

**Contributions**

As per Section 6, the contribution which shall be paid by the employer to the Fund shall be 10%, of the basic wages, dearness allowance and retaining allowance, if any, for the time being payable to each of the employees whether employed by him directly or through a contractor and the employees contribution shall be equal to the contribution payable by the employer. Employees, if they desire, may make contribution exceeding the prescribed rate but subject to the condition that employer shall not be under any obligation to contribute over and above the contribution payable as prescribed by the Government from time to time under the Act.

Each contribution shall be calculated to the nearest rupee, fifty paise or more to be counted as the next higher rupee and fraction of a rupee less than fifty paise to be ignored.

Dearness allowance shall include the cash value of any food concession allowed to an employee. Retaining allowance is the allowance payable to an employee for retaining his services, when the establishment is not working.

The Provident Fund Scheme has made the payment of contribution mandatory and the Act provides for no exception under which a specified employer can avoid his mandatory liability (State v. S.P. Chandani, AIR 1959 Pat. 9).

**Investment:** The amount received by way of Provident Fund contributions is invested by the Board of Trustees in accordance with the investment pattern approved by the Government of India. The members of the Provident Fund get interest on the money standing to their credit in their Provident Fund Accounts. The rate of interest for each financial year is recommended by the Board of Trustees and is subject to final decision by the Government of India.

**Advances/Withdrawals:** Advances from the Provident Fund can be taken for the following purposes subject to conditions laid down in the relevant paras of the Employees Provident Fund Scheme:

(1) Non-refundable advance for payment of premia towards a policy or policies of Life Insurance of a member;

(2) Withdrawal for purchasing a dwelling house or flat or for construction of a dwelling house including the acquisition of a suitable site for the purpose, or for completing/continuing the construction of a dwelling house, already commenced by the member or the spouse and an additional advance for additions, alteration or substantial improvement necessary to the dwelling house;

(3) Non-refundable advance to members due to temporary closure of any factory or establishment for more than fifteen days, for reasons other than a strike or due to non-receipt of wages for 2 months or more, and refundable advance due to closure of the factory or establishment for more than six months;

(4)

i. Non-refundable in case of:

(a) hospitalisation lasting one month or more, or

(b) major surgical operation in a hospital, or

(c) suffering from T.B., Leprosy, Paralysis, Cancer, Mental derangement or heart ailment, for the treatment of which leave has been granted by the employer;

ii. Non-refundable advance for the treatment of a member of his family, who has been hospitalised or requires hospitalisation, for one month or more:

(a) for a major surgical operation; or

(b) for the treatment of T.B., Leprosy, Paralysis, Cancer, mental derangement or heart ailment;

(5) Non-refundable advance for daughter/sons marriage, self-marriage, the marriage of sister/brother or for the post matriculation education of son or daughter;

(6) Non-refundable advance to members affected by cut in the supply of electricity;

(7) Non-refundable advance in case property is damaged by a calamity of exceptional nature such as floods, earthquakes or riots;

(8) Withdrawals for repayment of loans in special cases; and

(9) Non-refundable advance to physically handicapped members for purchasing an equipment required to minimise the hardship on account of handicap.

**Final withdrawal:** Full accumulations with interest thereon are refunded in the event of death, permanent disability, superannuation, retrenchment or migration from India for permanent settlement abroad/taking employment abroad, voluntary retirement, certain discharges from employment under Industrial Disputes Act, 1947, transfer to an establishment/factory not covered under the Act.

In other cases, with permission of commissioner or any subordinate officer to him, a member is allowed to draw full amount when he ceases to be in employment and has not been employed in any establishment to which the Act applies for a continuous period of

atleast 2 months. This requirement of 2 months waiting period shall not apply in cases of female members resigning from service for the purpose of getting married.

## (B) Employees' Pension Scheme

Under Section 6A, Government has introduced a new pension scheme styled Employees' Pension Scheme, 1995 w.e.f. 16.11.1995, in place of Family Pension Scheme, 1971.

The Employees' Pension Scheme is compulsory for all the persons who were members of the Family Pension Scheme, 1971. It is also compulsory for the persons who become members of the Provident Fund from 16.11.1995 i.e. the date of introduction of the Scheme. The PF subscribers who were not members of the Family Pension Scheme, have an option to join this Pension Scheme. The Scheme came into operation w.e.f. 16.11.1995, but the employees, including those covered under the Voluntary Retirement Scheme have an option to join the scheme w.e.f. 1.4.1993.

Minimum 10 years contributory service is required for entitlement to pension. Normal superannuation pension is payable on attaining the age of 58 years. Pension on a discounted rate is also payable on attaining the age of 50 years. Where pensionable service is less than 10 years, the member has an option to remain covered for pensionary benefits till 58 years of age or claim return of contribution/ withdrawal benefits.

The Scheme provides for payment of monthly pension in the following contingencies(a) Superannuation on attaining the age of 58 years; (b) Retirement; (c) Permanent total disablement; (d) Death during service; (e) Death after retirement/ superannuation/permanent total disablement; (f) Children Pension; and (g) Orphan pension.

The amount of monthly pension will vary from member to member depending upon his pensionable salary and pensionable service.

## (C) Employees' Deposit-Linked Insurance Scheme

The Act was amended in 1976 and a new Section 6C was inserted empowering the Central Government to frame a Scheme to be called the Employees' Deposit-Linked Insurance Scheme for the purpose of providing life insurance benefit to the employees of any establishment or class of establishments to which the Act applies.

The Central Government has accordingly framed the Employees' Deposits-Linked Insurance Scheme, 1976. It came into force on the 1st August, 1976.

1. **Application of the Scheme:** The Employees Deposit-Linked Insurance Scheme, 1976 is applicable to all factories/establishments to which the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 applies. AII the employees who are members of the Provident Funds in both the exempted and the unexempted establishments are covered under the scheme.
2. **Contributions to the Insurance Fund:** The employees are not required to contribute to the Insurance Fund. The employers are required to pay contributions to the Insurance Fund at the rate of 1% of the total emoluments, i.e., basic wages, dearness allowance including, cash value of any food concession and retaining allowance, if any.

3. **Administrative expenses:** The employers of all covered establishments are required to pay charges to the Insurance Fund.
4. **Nomination:** The nomination made by a member under the Employee Provident Fund Scheme 1952 or in the exempted provident fund is treated as nomination under this scheme. Provisions of Section 5 have overriding effect and will override the personal laws of the subscriber in the matters of nominations (LU I 1996 AII. 236).
5. **Payment of assurance benefit:** In case of death of a member, an amount equal to the average balance in the account of the deceased during the preceding 12 months or period of membership, whichever is less shall be paid to the persons eligible to receive the amount or the Provident Fund accumulations.
6. **Exemption from the Scheme:** Factories/establishments, which have an Insurance Scheme conferring more benefits than those provided under the statutory Scheme, may be granted exemption, subject to certain conditions, if majority of the employees are in favour of such exemption.

## DETERMINATION OF MONEYS DUE FROM EMPLOYERS

### (i) Determination of Moneys Due

Section 7A vests the powers of determining the amount due from any employer under the provisions of this Act and deciding the dispute regarding applicability of this Act in the Central Provident Fund Commissioner,

Additional Provident Fund Commissioner, Deputy Provident Fund Commissioner, or Regional Provident Fund Commissioner. For this purpose he may conduct such inquiry as he may deem necessary.

Central Government has already constituted Employees Provident Fund Appellate Tribunal, consisting of a presiding officer who is qualified to be a High Court Judge or a District Judge with effect from 1st July, 1997 in accordance with provisions of Section 7D. The term, service conditions and appointment of supporting staff are governed by Sections 7E to 7H. Any person aggrieved by order/notification issued by Central Government/ authority under Sections 1(3), 1(4), 3, 7A(1), 7C, 14B or 7B (except an order rejecting an application for review) may prefer an appeal. The tribunal shall prescribe its own procedure and have all powers vested in officers under Section 7A.

The proceedings before the tribunal shall be deemed to be a judicial proceeding within the meaning of Sections 193 and 228 and for Section 196 of Indian Penal Code and Civil, 1908, it shall be deemed to be a Civil Court for all purposes of Section 195 and Chapter XXVI of Code of Procedure. The appellant can take assistance of legal practitioner and the Government shall appoint a presenting officer to represent it. Any order made by the Tribunal finally disposing of the appeal cannot be questioned in any Court.

### (ii) Mode of recovery of moneys due from employee

Section 8 prescribes the mode of recovery of moneys due from employers by the Central Provident Fund Commissioner or such officer as may be authorised by him by notification in the Official Gazette in this behalf in the same manner as an arrear of land revenue.

Recovery of arrears of Provident Fund cannot be effected from unutilised part of cash-credit of an industrial establishment (1998 LAB IC Kar 3044).

### (iii) Recovery of moneys by employers and contractors

Section 8A lays down that the amount of contribution that is to say the employer's contribution as well as the employee's contribution and any charges for meeting the cost of administering the Fund paid or payable by an employer in respect of an employee employed by or through a contractor, may be recovered by such employer from the contractor either by deduction from any amount payable to the contractor under any contract or as a debt payable by the contractor.

A contractor from whom the amounts mentioned above, may be recovered in respect of any employee employed by or through him, may recover from such employee, the employee's contribution under any scheme by deduction from the basic wages, dearness allowance and retaining allowance, if any, payable to such employee. However, notwithstanding any contract to the contrary, no contractor shall be entitled to deduct the employer's contribution or the charges referred to above from the basic wages, dearness allowance and retaining allowance payable to an employee employed by or through him or otherwise to recover such contribution or charges from such employee.

### (iv) Measures for recovery of amount due from employer

The authorised officer under this Act shall issue a certificate for recovery of amount due from employer to the Recovery Officer. The Recovery Officer has got the powers to attach/sell the property of employer, call for arrest and detention of employer, etc. for effecting recovery. The employer cannot challenge the validity of the certificate. The authorised officer can grant time to the employer to make the payment of dues

The Central Provident Fund Commissioner may require any person, from whom amount is due to the employer, o pay directly to the Central Provident Fund Commissioner/Officer so authorised and the same will be treated as discharge of his liability to the employer to the extent of amount so paid. (Sections 8B to 8G)

### (v) Priority of payment of contributions over other debts

Section 11 of the Act provides that the contribution towards Provident Fund shall rank prior to other payments in the event of employer being adjudicated insolvent or where it is a company on which order of winding up has been made. The amount shall include:

(a) the amount due from the employer in relation to an establishment to which any Scheme or Insurance Scheme applies in respect of any contribution payable to the Fund, or the Insurance, damages recoverable under Section 14B, accumulations required to be transferred under sub-section (2) of Section 15 or any charges payable by him under any other provisions of this Act or of any provision of the Scheme or the Insurance Scheme; or

(b) the amount due from employer in relation to an exempted establishment in respect of any contribution to the Provident Fund or any Insurance Fund in so far as it relates to exempted employees under the rules of the Provident Fund, or any Insurance Fund or any contribution payable by him towards the Pension

Fund under Sub-section (6) of Section 17, damages recoverable under Section 13B or any charges payable by him to the appropriate Government under any provisions of this Act or any of the conditions specified under Section 17.

## EMPLOYER NOT TO REDUCE WAGES

Section 12 prohibits an employer not to reduce directly or indirectly the wages of any employee to whom the Scheme or the Insurance Scheme applies or the total quantum of benefits in the nature of old age pension, gratuity or provident fund or life insurance to which the employee is entitled under the terms of employment, express or implied, simply by reason of his liability for the payment of any contribution to the Fund or the Insurance Fund or any charges under this Act or the Scheme or the Insurance Scheme.

## TRANSFER OF ACCOUNTS

Section 17A(1) of the Act provides that where an employee employed in an establishment to which this Act applies leaves his employment and obtain re-employment in another establishment to which this Act does not apply, the amount of accumulations to the credit of such employee in the Fund, or as the case may be, in the Provident Fund of the establishment left by him shall be transferred within such time as may be specified by Central Government in this behalf to the credit of his account in the Provident Fund of the establishment in which he is re-employed, if the employee so desires and the rules in relation to that Provident Fund permit such transfer.

Sub-section (2) further provides that where as employee employed in an establishment to which this Act does not apply, leaves his employment and obtain re-employment in another establishment to which this Act applies, the amount of accumulations to the credit of such employee in the Provident Fund of the establishment left by him, may, if the employee so desires and also rules in relation to such Provident Fund permit, be transferred to the credit of his account in the Fund or as the case may be, in the Provident Fund of the establishment in which he is re-employed.

## PROTECTION AGAINST ATTACHMENT

Statutory protection is provided to the amount of contribution to Provident Fund under Section 10 from attachment to any Court decree. Sub-section (1) of Section 10 provides that the amount standing to the credit of any member in the Fund or any exempted employee in a Provident fund shall not in any way, be capable of being assigned or charged and shall not be liable to attachment under any decree or order or any Court in respect of any debt or liability incurred by the member or the exempted employee and neither the official assignee appointed under the Presidency Towns Insolvency Act, 1909 nor any receiver appointed under the Provincial Insolvency Act, 1920 shall be entitled to or have any claim on any such amount.

It is further provided in sub-section (2) that any amount standing to the credit of a member in the Fund or of an exempted employee in a Provident Fund at the time of his death and payable to his nominee under the Scheme or the rules of the Provident Fund shall, subject to any deduction authorised by the said scheme or rules, vest in the nominee and shall be free from any debt or other liability incurred by the deceased or the nominee before the death of the member or of the exempted employee and shall also not be liable to attachment under any decree or order of any Court. There is a statutory vesting of the fund on dependents

after the death of the subscriber which on such vesting becomes absolute property of dependent and cannot be held to have inherited by dependent.

The above provision shall apply in relation to the Employees' Pension Scheme or any other amount payable under the Insurance Scheme as they apply in relation to any amount payable out of the fund.

## POWER TO EXEMPT

Section 17 authorises the appropriate Government to grant exemptions to certain establishments or persons from the operation of all or any of the provisions of the Scheme. Such exemption shall be granted by notification in the Official Gazette subject to such conditions as may be specified therein.

# Social Security Legislations

## Unit III – Maternity Benefit Act, 1961

The Maternity Benefit Act, 1961 regulates employment of women in certain establishments for a certain period before and after childbirth and provides for maternity and other benefits. It extends to the whole of India.

## INTRODUCTION

Article 39(e) &(f) of the Constitution of India provides that the State shall, in particular, direct its policy towards securing that the health and strength of workers, men and women, and the tender age of children are not abused and that citizens are not forced by economic necessity to enter avocations unsuited to their age or strength; and that children are given opportunities and facilities to develop in a healthy manner and in conditions of freedom and dignity and that childhood and youth are protected against exploitation and against moral and material abandonment.

Maternity Benefits are aimed to protect the dignity of motherhood by providing for the full and healthy maintenance of women and her child when she is not working.

### Applicability of Act

The Maternity Benefit Act, 1961 is applicable to mines, factories, circus industry, plantations, shops and establishments employing 10 or more persons. It can be extended to other establishments by the State Governments.

### Definition

**"Appropriate Government"** means

| | |
|---|---|
| Central Government | in relation to:<br>- an establishment being a mine or<br>- an establishment wherein persons are employed for the exhibition of equestrian acrobatic and other performances |
| State Government | in relation to any other establishment |

**"Child"** includes a still-born child.

**"Commissioning Mother"** means a biological mother who uses her egg to create an embryo implanted in any other woman.

**"Employer"** means —

(i) in relation to an establishment which is under the control of the government a person or authority appointed by the government for the supervision and control of employees or where no person or authority is so appointed the head of the department;

(ii) in relation to an establishment under any local authority the person appointed by such authority for the supervision and control of employees or where no person is so appointed the chief executive officer of the local authority;

(iii) in any other case the person who or the authority which has the ultimate control over the affairs of the establishment and where the said affairs and entrusted to any other person whether called a manager managing director managing agent or by any other name such person; {Section 3(d)}

**"Establishment"** means —

(i) a factory;

(ii) a mine;

(iii) a plantation;

(iv) an establishment wherein persons are employed for the exhibition of equestrian acrobatic and other performance;

(v) a shop or establishment; or

(vi) an establishment to which the provisions of this Act have been declared;

**"Wages"** means all remuneration paid or payable in cash to a woman if the terms of the contract of employment express or implied were fulfilled and includes -

(1) such cash allowances (including dearness allowance and house rent allowances) as a woman is for the time being entitled to

(2) incentive bonus and

(3) the money value of the concessional supply of food grains and other articles

but does not include —

(i) any bonus other than incentive bonus;

(ii) over-time earnings and any deduction or payment made on account of fines;

(iii) any contribution paid or payable by the employer to any pension fund or provident fund or for the benefit of the woman under any law for the time being in force; and

(iv) any gratuity payable on the termination of service;

## Employment of or work by women prohibited during certain periods

Section 4 of the Act provides that no employer shall knowingly employ a woman in any establishment during the 6 weeks immediately following the day of her delivery, miscarriage or medical termination of pregnancy.

It also specifies that no women shall work in any establishment during the 6 weeks immediately following the day of her delivery, miscarriage or medical termination of pregnancy.

It may be noted that if a pregnant women makes request to her employer, she shall not be given to do during the period of 1 month immediately preceding the period of 6 weeks, before the date of her expected delivery, any work which is of an arduous nature or which involves long hours of standing, or which in any way is likely to interfere with her pregnancy or the

normal development of the fetus, or is likely to cause her miscarriage or otherwise to adversely affect her health.

## Right to payment of maternity benefits

Every woman shall be entitled to, and her employer shall be liable for, the payment of maternity benefit at the rate of the average daily wage for the period of her actual absence, that is to say:

- the period immediately preceding the day of her delivery,
- the actual day of her delivery and
- any period immediately following that day.

The average daily wage means the average of the woman's wages payable to her for the days on which she has worked during the period of 3 calendar months immediately preceding the date from which she absents herself on account of maternity, the minimum rate of wage fixed or revised under the Minimum Wages Act, 1948 or Rs. 10, whichever is the highest.

A woman shall be entitled to maternity benefit if she has actually worked in an establishment of the employer from whom she claims maternity benefit, for a period of not less than 80 days in the 12 months immediately preceding the date of her expected delivery.

The maximum period for which any woman shall be entitled to maternity benefit shall be 26 weeks of which not more than 8 weeks shall precede the date of her expected delivery. However, the maximum period entitled to maternity benefit by a woman having two or more than two surviving children shall be 12 weeks of which not more than 6 weeks shall precede the date of her expected delivery. If a woman dies during this period, the maternity benefit shall be payable only for the days up to and including the day of her death.

Where a woman, having been delivered of a child, dies during her delivery or during the period immediately following the date of her delivery for which she is entitled for the maternity benefit, leaving behind in either case the child, the employer shall be liable for the maternity benefit for that entire period. If the child also dies during the said period, then, for the days up to and including the date of the death of the child.

A woman who legally adopts a child below the age of 3 months or a commissioning mother shall be entitled to maternity benefit for a period of 12 weeks from the date the child is handed over to the adopting mother or the commissioning mother, as the case may be.

In case where the nature of work assigned to a woman is of such nature that she may work from home, the employer may allow her to do so after availing of the maternity benefit for such period and on such conditions as the employer and the woman may mutually agree.

## Notice of claim for maternity benefit (Section 6)

As per the section any woman employed in an establishment and entitled to maternity benefit under the provisions of this Act may give notice in writing in prescribed form, to her employer, stating that her maternity benefit and any other amount to which she may be entitled under this Act may be paid to her or to such person as she may nominate in the notice and that she will not work in any establishment during the period for which she receives maternity benefit.

In the case of a woman who is pregnant, such notice shall state the date from which she will be absent from work, not being a date earlier than 6 weeks from the date of her expected

delivery. Any woman who has not given the notice when she was pregnant may give such notice as soon as possible after the delivery.

On receipt of the notice, the employer shall permit such woman to absent herself from the establishment during the period for which she receives the maternity benefit. The amount of maternity benefit for the period preceding the date of her expected delivery shall be paid in advance by the employer to the woman on production of such proof, that the woman is pregnant, and the amount due for the subsequent period shall be paid by the employer to the woman within forty-eight hours of production of such proof as may be prescribed that the woman has been delivered of a child.

## Nursing breaks

Every woman delivered of a child who returns to duty after such delivery shall, in addition to the interval for rest allowed to her, be allowed in the course of her daily work 2 breaks of the prescribed duration for nursing the child until the child attains the age of 15 months.

## Creche Facility

Every establishment having 50 or more employees shall have the facility of creche within such distance as may be prescribed, either separately or along with common facilities. The employer shall allow 4 visits a day to the creche by the woman, which shall also include the interval for rest allowed to her.

Every establishment shall intimate in writing and electronically to every woman at the time of her initial appointment regarding every benefit available under the Act.

## Abstract of Act and Rules there under to be exhibited

As per section 19 an abstract of the provisions of this Act and the rules made there under in the language or languages of the locality shall be exhibited in a conspicuous place by the employer in every part of the establishment in which women are employed.

## Registers

Every employer shall prepare and maintain such registers, records and muster-rolls and in prescribed manner under section 20 of the Act.

## Penalty for contravention of Act by employer

Section 21 provides that if any employer fails to pay any amount of maternity benefit to a woman entitled under this Act or discharges or dismisses such woman during or on account of her absence from work in accordance with the provisions of the Act, he shall be punishable with imprisonment which shall not be less than 3 months but which may extend to 1 year and with fine which shall not be less than Rs. 2,000 but which may extend to Rs. 5,000. However, the court may, for sufficient reasons to be recorded in writing, impose a sentence of imprisonment for a lesser term or fine only in lieu of imprisonment.

If any employer contravenes the provisions of the Act or the rules made thereunder, he shall, if no other penalty is elsewhere provided by or under the Act for such contravention, be punishable with imprisonment which may extend to 1 year, or with fine which may extend to Rs. 5,000, or with both. Where the contravention is of any provision regarding maternity benefit or regarding payment of any other amount and such maternity benefit or amount has

not already been recovered, the court shall, in addition, recover such maternity benefit or amount as if it were a fine and pay the same to the person entitled thereto.

# Social Security Legislations

# Unit IV- Payment of Gratuity Act, 1972

The Payment of Gratuity Act, 1972 provides for the payment of gratuity to employees engaged in factories, mines, oilfields, plantations, ports, railway companies, shops or other establishments and for matters connected therewith or incidental thereto. It extends to the whole of India.

## INTRODUCTION

Gratuity is a lump sum payment made by the employer as a mark of recognition of the service rendered by the employee when he retires or leaves service. The Payment of Gratuity Act provides for the payment of gratuity to employees engaged in factories, mines, oilfields, plantations, ports, railway companies, shops or other establishments.

The Payment of Gratuity Act has been amended from time to time to bring it in tune with the prevailing situation. The Act has been amended to enhance the ceiling on amount of gratuity from Rs.10 lakh to Rs.20 lakh as well as to widen the scope of the definition of "employee" under section 2 (e) of the Act.

## APPLICATION OF THE ACT

Application of the Act to an employed person depends on two factors. Firstly, he should be employed in an establishment to which the Act applies. Secondly, he should be an "employee" as defined in Section 2(e). According to Section 1(3), the Act applies to:

(a) every factory, mine, oilfield, plantation, port and railway company;
(b) every shop or establishment within the meaning of any law for the time being in force in relation to shops and establishments in a State, in which ten or more persons are employed, or were employed, on any day of the preceding twelve months;
(c) such other establishments or class of establishments in which ten or more employees are employed, or were employed, on any day of the preceding twelve months as the Central Government may, by notification specify in this behalf.

In exercise of the powers conferred by clause (c), the Central Government has specified Motor transport undertakings, Clubs, Chambers of Commerce and Industry, Inland Water Transport establishments, Solicitors offices, Local bodies, Educational Institutions, Societies, Trusts and Circus industry, in which 10 or more persons are employed or were employed on any day of the preceding 12 months, as classes of establishments to which the Act shall apply.

A shop or establishment to which the Act has become applicable once, continues to be governed by it, even if the number of persons employed therein at any time after it has become so applicable falls below ten. (Section 3A)

## WHO IS AN EMPLOYEE?

The definition of "employee" under section 2 (e) of the Act has been amended by the Payment of Gratuity (Amendment) Act, 2009 to cover the teachers in educational institutions retrospectively with effect from 3rd April, 1997. The amendment to the definition of "employee" has been introduced in pursuance to the judgment of Supreme Court in Ahmedabad Private Primary Teachers' Association v. Administrative Officer, AIR 2004 SC 1426.

According to Section 2(e) as amended by the Payment of Gratuity (Amendment) Act, 2009 "employee" means any person (other than an apprentice) who is employed for wages, whether the terms of such employment are express or implied, in any kind of work, manual or otherwise, in or in connection with the work of a factory, mine, oilfield, plantation, port, railway company, shop or other establishment to which this Act applies, but does not include any such person who holds a post under the Central Government or a State Government and is governed by any other Act or by any rules providing for payment of gratuity.

## OTHER IMPORTANT DEFINITIONS

### Appropriate Government

"Appropriate Government" means:

i. in relation to an establishment:
   (a) belonging to, or under the control of, the Central Government,
   (b) having branches in more than one State,
   (c) of a factory belonging to, or under the control of the Central Government.
   (d) of a major port, mine, oilfield or railway company, the Central Government.
ii. in any other case, the State Government. [Section 2(a)]

It may be noted that many large establishments have branches in more than one State. In such cases the 'appropriate Government' is the Central Government and any dispute connected with the payment or nonpayment of gratuity falls within the jurisdiction of the 'Controlling Authority' and the 'Appellate Authority' appointed by the Central Government under Sections 3 and 7.

A Company Secretary should know whether the 'appropriate Government' in relation to his establishment is the Central Government or the State Government. He should also find out who has been notified as the 'Controlling Authority' and also who is the 'Appellate Authority'. It may be noted that any request for exemption under Section 5 of the Act is also to be addressed to the 'appropriate Government'. It is, therefore, necessary to be clear on this point.

### Continuous Service

According to Section 2A, for the purposes of this Act:

(1) An employee shall be said to be in 'continuous service' for a period if he has, for that period been in uninterrupted service, including service which may be interrupted on account of sickness, accident, leave, absence from duty without leave (not being absence in respect of which an order treating the absence as break in service has been passed in accordance with the standing orders, rules or regulations governing the employees of the establishment), layoff, strike or a lock-out or cessation of work not due to any fault of the employee, whether such uninterrupted or interrupted service was rendered before or after the commencement of this Act;

(2) Where an employee (not being an employee employed in a seasonal establishment) is not in continuous service within the meaning of clause (1) for any period of one year or six months, he shall be deemed to be in continuous service under the employer:
   (a) for the said period of one year, if the employee during the period of twelve calendar months preceding the date with reference to which calculation is to be made, has actually worked under the employer for not less than:

(i) one hundred and ninety days in the case of an employee employed below the ground in a mine or in an establishment which works for less than six days in a week; and

(ii) two hundred and forty, days in any other case;

(b) for the said period of six months, if the employee during the period of six calendar months preceding the date with reference to which the calculation is to be made, has actually worked under the employer for not less than:

(i) ninety five days, in the case of an employee employed below the ground in a mine or in an establishment which works for less than six days in a week; and

(ii) one hundred and twenty days in any other case;

Explanation: For the purpose of clause (2), the number of days on which an employee has actually worked under an employer shall include the days on which:

(i) he has been laid-off under an agreement or as permitted by standing orders made under the Industrial Employment (Standing Orders) Act, 1946, or under the Industrial Disputes Act, 1947, or under any other law applicable to the establishment;

(ii) he has been on leave with full wages, earned in the previous year;

(iii) he has been absent due to temporary disablement caused by accident arising out of and in the course of his employment; and

(iv) in the case of a female, she has been on maternity leave; so however, that the total period of such maternity leave does not exceed Melve weeks.

(3) Where an employee, employed in a seasonal establishment, is not in continues service within the meaning of clause (1) for any period of one year or six months, he shall be deemed to be in continuous service under the employer for such period if he has actually worked for not less than seventy-five per cent, of the number of days on which the establishment was in operation during such period.Service is not continuous, in case of legal termination of service and subsequent re-employment.Gratuity cannot be claimed on the basis of continuous service on being taken back in service after break in service of one and a half year on account of termination of service for taking part in an illegal strike, where the employee had accepted gratuity for previous service and later withdrawn from the industrial dispute (Baluram v. Phoenix Mills Ltd., 1999 CLA Born. 19).

## Family

Family, in relation to an employee, shall be deemed to consist of:

(i) in case of a male employee, himself, his wife, his children, whether married or unmarried, his dependent parents and the dependent parents of his wife and the widow and children of his predeceased son, if any,

(ii) in the case of a female employee, herself, her husband, her children, whether married or unmarried, her dependent parents and the dependent parents of her husband and the widow and children of her predeceased son, if any. [Section 2(h)]

Explanation: Where the personal law of an employee permits the adoption by him of a child, any child lawfully adopted by him shall be deemed to be included in his family, and where a child of an employee has been adopted by another person and such adoption is, under the personal law of the person making such adoption lawful, such child shall be deemed to be excluded from the family of the employee.

### Retirement

"Retirement" means termination of the service of an employee otherwise than on superannuation. [Section 2(q)]

### Superannuation

"Superannuation" in relation to an employee, means the attainment by the employee of such age as is fixed in the contract or conditions of service as the age on the attainment of which the employee shall vacate the employment. [Section 2(r)]

### Wages

"Wages" means all emoluments which are earned by an employee while on duty or on leave in accordance with the terms and conditions of his employment and which are paid or are payable to him in cash and includes dearness allowance but does not include any bonus, commission, house rent allowance, overtime wages and any other allowance. [Section 2(s)]

## WHEN IS GRATUITY PAYABLE?

According to Section 4(1) of the Payment of Gratuity Act, 1972, gratuity shall be payable to an employee on the termination of his employment after he has rendered continuous service for not less than five years:

(a) on his superannuation, or
(b) on his retirement or resignation, or
(c) on his death or disablement due to accident or disease.

Note: The completion of continuous service of five years is not necessary where the termination of the employment of any employee is due to death or disablement.

Further, the period of continuous service is to be reckoned from the date of employment and not from the date of commencement of this Act (CLA-1996-III-13 Mad.). Mere absence from duty without leave cannot be said to result in breach of continuity of service for the purpose of this Act. [Kothari Industrial Corporation v. Appellate Authority, 1998 Lab IC, 1149 (AP)]

## TO WHOM IS GRATUITY PAYABLE?

It is payable normally to the employee himself. However, in the case of death of the employee, it shall be paid to his nominee and if no nomination has been made, to his heirs and where any such nominees or heirs is a minor, the share of such minor, shall be deposited with the controlling authority who shall invest the same for the benefit of such minor in such bank or other financial institution, as may be prescribed, until such minor attains majority.

### Amount of Gratuity Payable

Gratuity is calculated on the basis of continuous service as defined above i.e. for every completed year of service or part in excess of six months, at the rate of fifteen days wages last drawn. The maximum amount of gratuity allowed under the Act is Rs. 20 lakh. The ceiling on the amount of gratuity from Rs. 10 lakh to Rs.20 lakh has been enhanced by the Payment of Gratuity (Amendment) Act, 2018.

### Nomination

An employee covered by the Act is required to make nomination in accordance with the Rules under the Act for the purpose of payment of gratuity in the event of his death. The rules also provide for change in nomination.

### Forfeiture of Gratuity

The Act deals with this issue in two parts. Section 4(6)(a) provides that the gratuity of an employee whose services have been terminated for any act of willful omission or negligence causing any damage or loss to, or destruction of, property belonging to the employer, gratuity shall be forfeited to the extent of the damage or loss or caused. The right of forfeiture is limited to the extent of damage. In absence of proof of the extent of damage, the right of forfeiture is not available (LU- 11-1996-515 MP).

Section 4(6)(b) deals with a case where the services of an employee have been terminated:

(a) for riotous and disorderly conduct or any other act of violence on his part, or
(b) for any act which constitutes an offence involving moral turpitude provided that such offence is committed by him in the course of his employment.

In such cases the gratuity payable to the employee may be wholly or partially forfeited. Where the service has not been terminated on any of the above grounds, the employer cannot withhold gratuity due to the employee. Where the land of the employer is not vacated by the employee, gratuity cannot be withheld (Travancore Plywood Ind. v. Regional JLC, Kerala, 1996 LU-II-14 Ker.). Assignment of gratuity is prohibited, it cannot be withheld for non vacation of service quarters by retiring employees (Air lndia v. Authority under the Act, 1999 CLA 34 Born. 66).

## EXEMPTIONS

The appropriate Government may exempt any factory or establishment covered by the Act or any employee or class of employees if the gratuity or pensionary benefits for the employees are not less favourable than conferred under the Act.

### The Controlling Authority and the Appellate Authority

The controlling authority and the Appellate Authority are two important functionaries in the operation of the Act. Section 3 of the Act says that the appropriate Government may by notification appoint any officer to be a Controlling Authority who shall be responsible for the administration of the Act. Different controlling authorities may be appointed for different areas.

Section 7(7) provides for an appeal being preferred against an order of the Controlling Authority to the appropriate Government or such other authority as may be specified by the appropriate Government in this behalf.

## RIGHTS AND OBLIGATIONS OF EMPLOYEES

### Application for Payment of Gratuity

Section 7(1) lays down that a person who is eligible for payment of gratuity under the Act or any person authorised, in writing, to act on his behalf shall send a written application to the employer. Rule 7 of the Payment of Gratuity (Central) Rules, 1972, provides that the application shall be made ordinarily within 30 days from the date gratuity becomes payable. The rules also provides that where the date of superannuation or retirement of an employee

is known, the employee may apply to the employer before 30 days of the date of superannuation or retirement.

A nominee of an employee who is eligible for payment of gratuity in the case of death of the employee shall apply to the employee ordinarily within 30 days from the date of the gratuity becomes payable to him. [Rule 7(2)]

Although the forms in which the applications are to be made have been laid down, an application on plain paper with relevant particulars is also accepted.

The application may be presented to the employer either by personal service or be registered post with acknowledgement due. An application for payment of gratuity filed after the period of 30 days mentioned above shall also be entertained by the employer if the application adduces sufficient cause for the delay in preferring him claim. Any dispute in this regard shall be referred to the Controlling Authority for his decision.

## RIGHTS AND OBLIGATIONS OF THE EMPLOYER

### Employers Duty to Determine and Pay Gratuity

Section 7(2) lays down that as soon as gratuity becomes payable the employer shall, whether the application has been made or not, determine the amount of gratuity and give notice in writing to the person to whom the gratuity is payable and also to the Controlling Authority, specifying the amount of gratuity so determined.

Section 7(3) of the Act says that the employer shall arrange to pay the amount of gratuity within thirty days from the date of its becoming payable to the person to whom it is payable.

Section 7(3A): If the amount of gratuity payable under sub-section (3) is not paid by the employer within the period specified in sub-section (3), the employer shall pay, from the date on which the gratuity becomes payable to the date on which it is paid, simple interest at the rate of 10 per cent per annum:

Provided that no such interest shall be payable if the delay in the payment is due to the fault of the employee and the employer has obtained permission in writing from the controlling authority for the delayed payment on this ground.

### Dispute as the Amount of Gratuity or Admissibility of the Claim

If the claim for gratuity is not found admissible, the employer shall issue a notice in the prescribed form to the applicant employee, nominee or legal heir, as the case may be, specifying reasons why the claim for gratuity is not considered admissible. A copy of the notice shall be endorsed to the Controlling Authority.

If the disputes relates as to the amount of gratuity payable, the employer shall deposit with the Controlling Authority such amount as he admits to be payable by him. According to Section 7(4)(e), the Controlling Authority shall pay the amount of deposit as soon as may be after a deposit is made:

(i) to the applicant where he is the employee; or
(ii) where the applicant is not the employee, to the nominee or heir of the employee if the Controlling Authority is satisfied that there is no dispute as to the right of the applicant to receive the amount of gratuity.

### Recovery of Gratuity

Section 8 provides that if the gratuity payable under the Act is not paid by the employer within the prescribed time, the Controlling Authority shall, on an application made to it in this behalf by the aggrieved person, issue a certificate for that amount to the Collector, who shall recover the same together with the compound interest thereon at such rate as the Central Government may be notification, specify, from the date of expiry of the prescribed time, as arrears of land revenue and pay the same to the person entitled thereto:

"Provided that the controlling authority shall, before issuing a certificate under this section, give the employer a reasonable opportunity of showing cause against the issue of such certificate:

Provided further that the amount of interest payable under this section shall, in no case, exceed the amount of gratuity payable under this Act".

**Protection of Gratuity**

Gratuity has been exempted from attachment in execution of any decree or order of any Civil, Revenue or Criminal Court. This relief is aimed at providing payment of gratuity to the person or persons entitled there to without being affected by any order of attachment by an decree of any Court.

# Social Security Legislations

# Unit V – Apprentices Act, 1961

The Apprentices Act, 1961 enacted to regulate and control the programme of training of apprentices and for matters connected therewith. It extends to whole of India.

## INTRODUCTION

The Apprentices Act, 1961 was enacted with the objective of regulating the programme of training of apprentices in the industry by utilising the facilities available therein for imparting on-the-job training. The Act was amended in 1973 and 1986 to include training of graduates, technicians and technician (vocational) apprentices respectively under its purview. It was further amended in 1997 and 2007 to amend various sections of the Act as regards definition of "establishment", "worker", number of apprentices for a designated trade and reservation for candidates belonging to Other Backward Classes, etc. Comparing the size and rate of growth of economy of India, the performance of Apprenticeship Training Scheme is not satisfactory and a large number of training facilities available in the industry are going unutilised depriving unemployed youth to avail the benefits of the Apprenticeship Training Scheme. Employers are of the opinion that provisions of the Act are too rigid to encourage them to engage apprentices and provision relating to penalty create fear amongst them of prosecution and they have suggested to modify the Apprentices Act suitably. In order to make the apprenticeship more responsive to youth and industry, the Apprentices Act, 1961 has been amended and brought into effect from 22nd December, 2014. The Apprentices (Amendment) Act, 2014 expanding the apprenticeship opportunities for youth. Non engineering graduates and diploma holders have been made eligible for apprenticeship. A portal is being setup to make all approvals transparent and time bound. Apprenticeship can be taken up in new occupations also.

### Definitions

Section 2 of the Act defines various terms used in the Act; Some of the definitions are given here under:

**Apprentice** means a person who is undergoing apprenticeship training in pursuance of a contract of apprenticeship. (Section 2(aa)}

**Apprenticeship training** means a course of training in any industry or establishment undergone in pursuance of a contract of apprenticeship and under prescribed terms and conditions which may be different for different categories of apprentices. (Section 2 (aaa)}

**Appropriate Government** means —

(1) in relation to —

- **a.** the Central Apprenticeship Council, or
- **aa.** the Regional Boards, or
- **aaa.** the practical training of graduate or technician apprentices or of technician (vocational) apprentices, or;
- **b.** any establishment of any railway, major port, mine or oilfield, or

**bb.** any establishment which is operating business or trade from different locations situated in four or more States, or

**c.** any establishment owned, controlled or managed by —

(i) the Central Government or a department of Central Government,

(ii) a company in which not less than fifty-one per cent of the share capital is held by the Central Government on partly by that Government and partly by one or more State Governments,

(iii) a corporation (including a co-operative society) established by or under a Central Act which is owned, controlled or managed by the Central Government;

the Central Government;

(2) in relation to —

(a) a State Apprenticeship Council, or

(b) any establishment other than an establishment specified in sub-clause (1) of this clause, the State Govt; {Section 2(d)}.

**Designated trade** means any trade or occupation or any subject field in engineering or non-engineering or technology or any vocational course which the Central Government, after consultation with the Central Apprenticeship Council, may, by notification in the Official Gazette, specify as a designated trade for the purposes of this Act. [Section 2(e)}.

**Employer** means any person who employs one or more other persons to do any work in an establishment for remuneration and includes any person entrusted with the supervision and control of employees in such establishment. [Section 2 (f)}

**Establishment** includes any place where any industry is carried on and where an establishment consists of different departments or have branches, whether situated in the same place or at different places, all such departments or branches shall be treated as part of that establishment. [Section 2 (g)}

**Graduate or technician apprentice** means an apprentice who holds, or is undergoing training in order that he may hold a degree or diploma in engineering or non-engineering or technology or equivalent qualification granted by any institution recognised by the Government and undergoes apprenticeship training in any designated trade. {Section 2(j)}

**Industry** means any industry or business in which any trade, occupation or subject field in engineering or nonengineering or technology or any vocational course may be specified as a designated trade or optional trade or both. {Section 2(k)}

**Optional trade** means any trade or occupation or any subject field in engineering or non-engineering or technology or any vocational course as may be determined by the employer for the purposes of this Act. {Section 2(II)}

**Portal-site** means a website of the Central Government for exchange of information under this Act. [Section 2(III)]

**Technician (vocational) apprentice** means an apprentice who holds or is undergoing training in order that he may hold a certificate in vocational course involving two years of study after the completion of the secondary stage of school education recognised by the All-India Council and undergoes apprenticeship training in designated trade. [Section 2(pp)]

**Trade Apprentice** means an apprentice who undergoes apprenticeship training in any designated trade. [Section 2(q)]

**Worker** means any person working in the premises of the employer, who is employed for wages in any kind of work either directly or through any agency including a contractor and who gets his wages directly or indirectly from the employer but shall not include an apprentice referred to in clause (aa). [Section 2(r)].

## Qualifications for being engaged as an apprentice

Section 3 of the Act provides that a person shall not be qualified for being engaged as an apprentice to undergo apprenticeship training in any designated trade, unless he —

(a) is not less than fourteen years of age, and for designated trades related to hazardous industries, not less than eighteen years of age; and
(b) satisfies such standards of education and physical fitness as may be prescribed: Provided that different standards may be prescribed in relation to apprenticeship training in different designated trades and for different categories of apprentices.

## Contract of apprenticeship

Section 4 of the Act deals with Contract of apprenticeship. Section 4 states that -

(1) No person shall be engaged as an apprentice to undergo apprenticeship training in a designated trade unless such person or, if he is minor, his guardian has entered into a contract of apprenticeship with the employer.
(2) The apprenticeship training shall be deemed to have commenced on the date on which the contract of apprenticeship has been entered into under sub-section (1).
(3) Every contract of apprenticeship may contain such terms and conditions as may be agreed to by the parties to the contract: Provided that no such term or condition shall be inconsistent with any provision of this Act or any rule made thereunder.
(4) Every contract of apprenticeship entered into under sub-section (1) shall be sent by the employer within thirty days to the Apprenticeship Adviser until a portal-site is developed by the Central Government, and thereafter the details of contract of apprenticeship shall be entered on the portal-site within seven days, for verification and registration.

(4A) In the case of objection in the contract of apprenticeship, the Apprenticeship Adviser shall convey the objection to the employer within fifteen days from the date of its receipt.

(4B) The Apprenticeship Adviser shall register the contract of apprenticeship within thirty days from the date of its receipt.

As per section 4(6) where the Central Government, after consulting the Central Apprenticeship Council, makes any rule varying the terms and conditions of apprenticeship training of any category of apprentices undergoing such training, then, the terms and conditions of every contract of apprenticeship relating to that category of apprentices and subsisting immediately before the making of such rule shall be deemed to have been modified accordingly.

## Novation of contracts of apprenticeship

Section 5 of the Act provides that where an employer with whom a contract of apprenticeship has been entered into, is for any reason unable to fulfil his obligations under the contract and with the approval of the Apprenticeship Adviser it is agreed between the employer, the apprentice or his guardian and any other employer that the apprentice shall be engaged as apprentice under the other employer for the unexpired portion of the period of apprenticeship training, the agreement, on registration with the Apprenticeship Adviser, shall be deemed to be the contract of apprenticeship between the apprentice or his guardian and other employer, and on and from the date of such registration, the contract of apprenticeship with the first employer shall terminate and no obligation under the contract shall be enforceable at the instance of any party to the contract against the other party thereto.

## Regulation of optional trade

Section 5A of the Act provides that the qualification, period of apprenticeship training, holding of test, grant of certificate and other conditions relating to the apprentices in optional trade shall be such as may be prescribed.

## Engagement of apprentices from other States

Under section 5B the employer may engage apprentices from other States for the purpose of providing apprenticeship training to the apprentices.

## Period of apprenticeship training

As per section 6 of the Act the period of apprenticeship training, which shall be specified in the contract of apprenticeship, shall be as follows —

(a) In the case of trade apprentices who, having undergone institutional training in a school or other institution recognised by the National Council, have passed the trade tests or examinations conducted by that Council or by an institution recognised by that Council , the period of apprenticeship training shall be such as may be prescribed.

(aa) in the case of trade apprentices who, having undergone institutional training in a school or other institution affiliated to or recognised by a Board or State Council of Technical Education or any other authority or courses approved under any scheme which the Central Government may, by notification in the Official Gazette specify in this behalf, have passed the trade tests or examinations conducted by that Board or State Council or authority or by any other agency authorised by the Central Government, the period of apprenticeship training shall be such as may be prescribed;

(b) in the case of other trade apprentices , the period of apprenticeship training shall be such as may be prescribed;

(c) in the case of graduate or technician apprentices, technician (vocational) apprentices and the period of apprenticeship training shall be such as may be prescribed.

## Number of apprentices for a designated trade and optional trade

Section 8 empowers the Central Government to prescribe the number of apprentices to be engaged by the employer for designated trade and optional trade. Several employers may join together either themselves or through an agency, approved by the Apprenticeship Adviser, according to the guidelines issued from time to time by the Central Government in this behalf, for the purpose of providing apprenticeship training to the apprentices under them.

## Practical and basic training of apprentices

Section 9 deals with practical and basic training of apprentices. Section 9 states that:

- Every employer shall make suitable arrangements in his workplace for imparting a course of practical training to every apprentice engaged by him.
- The Central Apprenticeship Adviser or any other person not below the rank of an Assistant Apprenticeship Adviser authorised by the State Apprenticeship Adviser in writing in this behalf shall be given all reasonable facilities for access to each such apprentice with a view to test his work and to ensure that the practical training is being imparted in accordance with the approved programme: Provided that the State Apprenticeship Adviser or any other person not below the rank of an Apprenticeship Adviser authorised by the State Apprenticeship Adviser in writing in this behalf shall also be given such facilities in respect of apprentices undergoing training in establishments in relation to which the appropriate Government is the State Government.
- Such of the trade apprentices who have not undergone institutional training in a school or other institution recognised by the National Council or any other institution affiliated to or recognised by a Board or State Council of Technical Education or any other authority which the Central Government may, by notification in the Official Gazette, specify in this behalf, shall, before admission in the workplace for practical training, undergo a course of basic training and the course of basic training shall be given to the trade apprentices in any institute having adequate facilities.
- In the case of an apprentice other than a graduate or technician apprentice or technician (vocational) apprentice, the syllabus of and the equipment to be utilised for, practical training including basic training in any designated trade shall be such as may be approved by the Central Government in consultation with the Central Apprenticeship Council.
- In the case of graduate or technician apprentices or technician (vocational) apprentices, the programme of apprenticeship training and the facilities required for such training in any designated trade shall be such as may be approved by the Central Government in consultation with the Central Apprenticeship Council.
- Recurring costs (including the cost of stipends) incurred by an employer in connection with basic training, imparted to trade apprentices other than those referred to in clauses (a) and (aa) of Section 6 shall be borne –
  (i) If such employer employs two hundred and fifty workers or more, by the employer;

(ii) If such employer employs less than two hundred and fifty workers, by the employer and the Government in equal shares up to such limit as may be laid down by the Central Government and beyond that limit, by the employer alone;

- Recurring costs (including the cost of stipends), if any, incurred by an employer in connection with practical training, including basic training, imparted to trade apprentices referred to in clauses (a) and (aa) of Section 6 shall, in every case, be borne by the employer.
- Recurring costs (excluding the cost of stipends) incurred by an employer in connection with the practical training imparted to graduate or technician apprentices technician (vocational) apprentices shall be borne by the employer and the cost of stipends shall be borne by the Central Government and the employer in equal shares up to such limit as may be laid down by the Central Government and beyond that limit, by the employer alone except apprentices who holds degree or diploma in non-engineering.

**Obligations of employers**

Every employer shall have the following obligations in relation to an apprentice, namely: –

- to provide the apprentice with the training in his trade in accordance with the provisions of the Act and the rules made thereunder;
- if the employer is not himself qualified in the trade, to ensure that a person who possesses the prescribed qualifications is placed in charge of the training of the apprentice;
- to provide adequate instructional staff, possessing such qualifications as may be prescribed for imparting practical and theoretical training and facilities for trade test of apprentices;
- to carry out his obligations under the contract of apprenticeship.

## Obligations of apprentice

Every trade apprentice undergoing apprenticeship training shall have the following obligations, namely: -

- to learn his trade conscientiously and diligently and endeavor to qualify himself as a skilled craftsman before the expiry of the period of training;
- to attend practical and instructional classes regularly;
- to carry out all lawful orders of his employer and superiors in the establishment; and
- to carry out his obligations under the contract of apprenticeship.
- Every graduate or technician apprentice, technician (vocational) apprentice undergoing apprenticeship training shall have the obligations to learn his subject field in engineering or technology or vocational course conscientiously and diligently at his place of training; to attend the practical and instructional classes regularly; to carry out all lawful orders of his employer and superiors in the establishment; to carry out his obligations under the contract of apprenticeship.

## Hours of work, overtime, leave and holidays

Section 15 of the Act deals with hours of work, overtime, leave and holidays. Section 15 provides that:

(1) The weekly and daily hours of work of an apprentice while undergoing practical training in a workplace shall be as determined by the employer subject to the compliance with the training duration, if prescribed.

(2) No apprentice shall be required or allowed to work overtime except with the approval of the Apprenticeship Adviser who shall not grant such approval unless he is satisfied that such overtime is in the interest of the training of the apprentice or in the public interest.

(3) An apprentice shall be entitled to such leave and holidays as are observed in the establishment in which he is undergoing training.

## Apprentices are trainees and not workers

Every apprentice undergoing apprenticeship training in a designated trade in an establishment shall be a trainee and not a worker and the provisions of any law with respect to labour shall not apply to or in relation to such apprentice.

## Records and returns

Section 19 of the Act provides that every employer shall maintain records of the progress of training of each apprentice undergoing apprenticeship training in his establishment in such form as may be prescribed.

Until a portal-site is developed by the Central Government, every employer shall furnish such information and return in such form as may be prescribed, to such authorities at such intervals as may be prescribed.

Every employer shall also give trade-wise requirement and engagement of apprentices in respect of apprenticeship training on portal-site developed by the Central Government in this regard.

## Settlement of disputes

As per section 20 of the Act any disagreement or dispute between an employer and an apprentice arising out of the contract of apprenticeship shall be referred to the Apprenticeship Adviser for decision.

Any person aggrieved by the decision of the Apprenticeship Adviser may, within thirty days from the date of communication to him of such decision, prefer an appeal against the decision to the Apprenticeship Council and such appeal shall be heard and determined by a Committee of that Council appointed for the purpose. The decision of the Committee and subject only to such decision, the decision of the Apprenticeship Adviser shall be final.

## Holding of test and grant of certificate and conclusion of training

Section 21(1) provides that every trade apprentice who has completed the period of training may appear for a test to be conducted by the National Council or any other agency authorised by the Central Government to determine his proficiency in the designated trade in which he has undergone apprenticeship training.

Every trade apprentice who passes the test referred to in sub-section (1) shall be granted a certificate of proficiency in the trade by the National Council or by the other agency authorised by the Central Government.

The progress in apprenticeship training of every graduate or technician apprentice shall be assessed by the employer from time to time. Every graduate or technician apprentice or technician (vocational) apprentice who completes his apprenticeship training to the satisfaction of the concerned Regional Board, shall be granted a certificate of proficiency by that Board.

## Offer and acceptance of employment

As per section 22(1) of the Act every employer shall formulate its own policy for recruiting any apprentice who has completed the period of apprenticeship training in his establishment.

Section 22(2) states that notwithstanding anything in sub-section (1), where there is a condition in a contract of apprenticeship that the apprentice shall, after the successful completion of the apprenticeship training, serve the employer, the employer shall, on such completion, be bound to offer suitable employment to the apprentice, and the apprentice shall be bound to serve the employer in that capacity for such period and on such remuneration as may be specified in the contract. Provided that where such period of remuneration is not, in the opinion of the Apprenticeship Adviser, reasonable, he may revise such period or remuneration so as to make it reasonable, and the period or remuneration so revised shall be deemed to the period of remuneration agreed to between the apprentice and the employer.

## Authorities under the Act

In addition to the Government, there are the following authorities under the Act, namely : –

(a) The National Council,
(b) The Central Apprenticeship Council,
(c) The State Council,
(d) The State Apprenticeship Council,
(e) The All India Council,
(f) The Regional Boards,
(g) The Boards or State Councils of Technical Education
(h) The Central Apprenticeship Adviser,
(i) The State Apprenticeship Adviser.

Every State Council shall be affiliated to the National Council and every State Apprenticeship Council shall be affiliated to the Central Apprenticeship Council. Every Board or State Council of Technical Education and every Regional Board shall be affiliated to the Central Apprenticeship Council.

Each of the authorities specifies above shall, in relation to apprenticeship training under the Act, perform such functions as are assigned to it by or under the Act or by the Government. However, a State Council shall also perform such functions as are assigned to it by the National Council and the State Apprenticeship Council and the Board or State Council of Technical Education shall also perform such functions as are assigned to it by the Central Apprenticeship Council.

## Offence and penalties

Section 30 deals with offences and penalties. Section 30 provides that-

(1) If any employer contravenes the provisions of the Act relating to the number of apprentices which he is required to engage under those provisions, he shall be given a month's notice in writing, by an officer duly authorised in this behalf by the appropriate Government, for explaining the reasons for such contravention.

**(1A)** In case the employer fails to reply the notice within the period specified under sub-section (1), or the authorised officer, after giving him an opportunity of being heard, is not satisfied with the reasons given by the employer, he shall be punishable with fine of five hundred rupees per shortfall of apprenticeship month for first three months and thereafter one thousand rupees per month till such number of seats are filled up.

(2) If any employer or any other person –

(a) required to furnish any information or return- (i) refuses or neglects to furnish such information or return, or (ii) furnishes or causes to be furnished any information or return which is false and which is either knows or believes to be false or does not believe to be true, or (iii) refuses to answer, or give a false answer to any question necessary for obtaining any information required to be furnished by him, or

(b) refuses or willfully neglects to afford the Central or the State Apprenticeship Adviser or such other person, not below the rank of an Assistant Apprenticeship Adviser, as may be authorised by the central or the State Apprenticeship Adviser in writing in this behalf any reasonable facility for making any entry, inspection, examination or inquiry authorised by or under this Act, or

(c) requires an apprentice to work overtime without the approval of the Apprenticeship Adviser, or

(d) employs an apprentice on any work which is not connected with his training, or

(e) makes payment to an apprentice on the basis of piece-work, or

(f) requires an apprentice to take part in any output bonus or incentive scheme.

(g) engages as an apprentice a person who is not qualified for being so engaged, or

(h) fails to carry out the terms and conditions of a contract of apprenticeship he shall be punishable with fine of one thousand rupees for every occurrence.

**(2A)** The provisions of this section shall not apply to any establishment or industry which is under the Board for Industrial and Financial Reconstruction established under the Sick Industrial Companies (Special Provisions) Act, 1985.

# Social Security Legislations

## Unit VI – Labour Laws (Simplification of Procedure for Furnishing Returns and Maintaining Registers by Certain Establishments) Act, 1988

The Labour Laws (Simplification of Procedure for Furnishing Returns and Maintaining Registers by Certain Establishments) Act, 1988 provides for the exemption of employers in relation to establishments employing a small number of persons from furnishing returns and maintaining registers under certain labour laws. It extends to the whole of India.

## INTRODUCTION

The Labour Laws (Exemption from Furnishing Returns and Maintaining Registers by certain Establishments) Amendment Act, 2014 amended the Labour Laws (Exemption from Furnishing Returns and Maintaining Registers by certain Establishments) Act, 1988.

The Labour Laws (Exemption from Furnishing Returns and Maintaining Registers by certain Establishments) Amendment Act, 2014 provides for the simplification of procedure for furnishing returns and maintaining registers in relation to establishments employing a small number of persons under certain labour laws.

Now this Act may be called the Labour Laws (Simplification of Procedure for Furnishing Returns and Maintaining Registers by Certain Establishments) Act, 1988.

The Amendment Act now includes 7 more Labour Acts under the purview of the Principal Act. Also, the coverage of Principal Act has been expanded from the establishments employing upto 19 workers to 40 workers.

The Amendment Act also gives an option to maintain the registers electronically and to file the returns electronically which leads to ease of compliance as well as better enforcement of the labour laws.

## Definitions

### Employer

Employer, in relation to a Scheduled Act, and in relation to any other Scheduled Act, means the person who is required to furnish returns or maintain registers under that Act.

### Establishment

Establishment has the meaning assigned to it in a Scheduled Act, and includes —

i. an "industrial or other establishment" as defined in Payment of Wages Act, 1936;
ii. a "factory" as defined in Factories Act, 1948;
iii. a factory, workshop or place where employees are employed or work is given out to workers, in any scheduled employment to which the minimum wages Act, 1948, applies.
iv. a "plantation" as defined in Plantations Labour Act, 1951; and
v. a "newspaper establishment" as defined in Working Journalists and other Newspaper Employees (conditions of Service) and Miscellaneous Provisions Act, 1955.

**Form**

Form means a Form specified in the Second Schedule.

Following forms are specified in the second schedule. They are as under:

- Form I -Annual Return (to be furnished to the Inspector or the authority specified for this purpose under the respective Scheduled Act before the 30th April of the following year)
- Form II -Register of persons employed-cum-employment card
- Form III- Muster roll-cum-wage register

**Scheduled Act**

Scheduled Act means an Act specified in the first Schedule and is in force on commencement of this Act in the territories to which such Act extends generally, and includes the rules made thereunder.

Following are the sixteen Acts specified in the first schedule. They are as under:

1. The Payment of Wages Act, 1936
2. The Weekly Holidays Act, 1942
3. The Minimum Wages Act, 1948
4. The Factories Act, 1948
5. The Plantations Labour Act, 1951
6. The Working Journalists and other Newspaper Employees (Conditions of Service) and Miscellaneous Provisions Act, 1955
7. The Motor Transport Workers Act, 1961
8. The Payment of Bonus Act, 1965
9. The Beedi and Cigar Workers (Conditions of Employment) Act, 1966
10. The Contract Labour (Regulation and Abolition) Act, 1970
11. The Sales Promotion Employees (Conditions of Service) Act, 1976
12. The Equal Remuneration Act, 1976
13. The Inter-State Migrant Workmen (Regulation of Employment and Conditions of Service) Act, 1979
14. The Dock Workers (Safety, Health and Welfare) Act, 1986
15. The Child Labour (Prohibition and Regulation) Act, 1986
16. The Building and Other Construction Workers (Regulation of Employment and Conditions of Service) Act, 1996.

**Small establishment**

Small establishment means an establishment in which not less than 10 and not more than 40 persons are employed or were employed on any day of the preceding 12 months.

**Very small establishment**

Very small establishment means an establishment in which not more than 9 persons are employed or were employed on any day of the preceding 12 months.

## Exemption from furnishing or maintaining of returns and registers required under certain labour laws

Section 4(1) of the Act provides that on and from the commencement of the Labour Laws (Exemption from Furnishing Returns and Maintaining Registers by certain Establishments) Amendment Act, 2014, it shall not be necessary for an employer in relation to any small establishment or very small establishment to which a Scheduled Act applies, to furnish the returns or to maintain the registers required to be furnished or maintained under that Scheduled Act.

It may be noted that such employer –

(a) furnishes, in lieu of such returns, annual return in Form I; and
(b) maintains at the work spot, in lieu of such registers, –
  - registers in Form II and Form III, in the case of small establishments, and
  - a register in Form III, in the case of very small establishments.

## Furnishing or maintaining of returns and registers in electronic form

As per Section 4 (2) of the Act, the annual return in Form I and the registers in Forms II and III and wage slips, wage books and other records, as provided in sub-section (1), may be maintained by an employer either in physical form or on a computer, computer floppy, diskette or other electronic media.

It may be noted that in case of computer, computer floppy, diskette or other electronic form, a printout of such returns, registers, books and records or a portion thereof is made available to the Inspector on demand.

Under section 4(3) the employer or the person responsible to furnish the annual return in Form I may furnish it to the Inspector or any other authority prescribed under the Scheduled Acts either in physical form or through electronic mail if the Inspector or the authority has the facility to receive such electronic mail.

## Penalty

As per section 6 of the Act, any employer who fails to comply with the provisions of the Act shall, on conviction, be punishable

- in the case of the first conviction, with fine which may extend to Rs. 5,000; and
- in the case of any second or subsequent conviction, with imprisonment for a period which shall not be less than 1 month but which may extend to 6 months or with fine which shall not be less than Rs. 10,000 but may extend to Rs. 25,000 or with both.

# Chapter 19 : Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013

Sexual harassment results in violation of the **fundamental rights of a woman to equality under Articles 14 and 15** of the Constitution of India and her **right to life and to live with dignity under Article 21** of the Constitution and right to practice any profession or to carry on any occupation, trade or business which includes a right to a safe environment free from sexual harassment.

Workplace sexual harassment in India, was for the very first time recognized by the Supreme Court of India in its landmark judgment of **Vishaka v. State of Rajasthan, 1997 SC ("Vishaka Judgment"),**

The protection against sexual harassment and the right to work with dignity are universally recognised human rights by international conventions and instruments such as **Convention on the Elimination of all Forms of Discrimination against Women;**

## FORMS OF WORKPLACE SEXUAL HARASSMENT

Workplace sexual harassment refers to most common forms of inappropriate behaviour:

- **Quid Pro Quo**
- **Hostile Work Environment**

## APPLICABILITY

The Act applies to both the organized and unorganized sectors **(self-employed or having less than 10 workers)** in India. It inter alia, applies to government bodies, private and public sector organizations, non-governmental organizations, organizations carrying out commercial, vocational, educational, entertainment, industrial, financial activities, hospitals and nursing homes, educational institutes, sports institutions and stadiums used for training individuals and also applies **to a dwelling place or a house.**

## DEFINITIONS (SECTION 2)

"Appropriate Government" means —

| | |
|---|---|
| in relation to a workplace which is established, owned, controlled or wholly or substantially financed by funds provided directly or indirectly **by the Central Government or the Union territory administration** | **the Central Government** |
| in relation to a workplace which is established, owned, controlled or wholly or substantially financed by funds provided directly or indirectly **by the State Government** | **the State Government** |
| in relation to any workplace not covered above **i.e., for the private sector, appropriate Government is the concerned State Government** | **the State Government** |

**"Domestic worker"** means

- a woman who is **employed to do the household work in any household** for remuneration
  - whether in cash or kind,
  - either directly or through any agency
  - on a temporary, permanent, part time or full-time basis;
- but **does not include any member of the family of the employer. [Section 2(e)]**

**"Employee" means**

- a person employed at a workplace for any work on regular, temporary, ad hoc or daily wage basis, either directly or through an agent, including a contractor, whether for remuneration or not, or working on a voluntary basis or otherwise, whether the terms of employment are express or implied and
- includes a co-worker, a contract worker, probationer, trainee, apprentice or called by any other such name.

**"Employer" means:**

| | |
|---|---|
| in relation to any department, organisation, undertaking, establishment, enterprise, institution, office, branch or unit of the appropriate Government or a local authority | the head of that department, organisation, undertaking, establishment, enterprise, institution, office, branch or unit or such other officer as the appropriate Government or the local authority, as the case may be, may by an order specify in this behalf; |
| in any workplace not covered above | any person responsible for the management, supervision and control of the workplace. |
| in relation to a dwelling place or house | a person or a household who employs or benefits from the employment of domestic worker, irrespective of the number, time period or type of such worker employed, or the nature of the employment or activities performed by the domestic worker. |

**"Respondent"** means a person against whom the aggrieved woman has made a complaint under section 9.

**"Sexual harassment"** includes any one or more of the following unwelcome acts or behaviour namely: –

i. physical contact and advances; or
ii. a demand or request for sexual favours; or
iii. making sexually coloured remarks; or
iv. showing pornography; or
v. any other unwelcome physical, verbal or non-verbal conduct of sexual nature.

The POSH Act defines 'sexual harassment' in line with the Supreme Court's definition of 'sexual harassment' in the Vishaka Judgment. The definition of 'sexual harassment' under the POSH Act is wide enough to cover both direct or implied sexual conduct which may involve physical, verbal or even written conduct. The key distinguishing feature is that the conduct is unwanted and unwelcome by the recipient.

An example would be a work environment where an individual is subject to unwelcome comments about her body type resulting in the woman employee feeling embarrassed and unable to work properly.

The Act has defined what constitutes sexual harassment under Section 2 (n) and under Section 3, has further widened the definition of sexual harassment by providing that any of the following circumstances, related to sexual harassment, may also amount to Sexual Harassment:

(1) implied or explicit promise of preferential treatment in the victim's employment;
(2) implied or explicit threat of detrimental treatment in the victim's employment;
(3) implied or explicit threat about the victim's present or future employment status;
(4) interferes with the victim's work or creating an intimidating or offensive or hostile work environment for her and
(5) humiliating treatment likely to affect the victim's health or safety.

Hence, a mere statement in a case where the plaintiff requested defendant No. 1 to instruct the attendants to switch off the A. C. Machine, but in reply defendant No. 1 said "... come close to me, you will start feeling hot", can also be construed to be sexual harassment [Albert Davit Limited vs. Anuradha Chowdhury and Ors., (2004) 2 CALLT 421 (HC)].

**According to section 2(o) "workplace"** includes –

a. any department, organisation, undertaking, establishment, enterprise, institution, office, branch or unit which is established, owned, controlled or wholly or substantially financed by funds provided directly or indirectly by the appropriate Government or the local authority or a Government company or a corporation or a co-operative society;
b. any private sector organisation or a private venture, undertaking, enterprise, institution, establishment, society, trust, non-governmental organisation, unit or service provider carrying on commercial, professional, vocational, educational, entertainmental, industrial, health services or financial activities including production, supply, sale, distribution or service;
c. hospitals or nursing homes;
d. any sports institute, stadium, sports complex or competition or games venue, whether residential or not used for training, sports or other activities relating thereto;
e. any place visited by the employee arising out of or during the course of employment including transportation provided by the employer for undertaking such journey;
f. a dwelling place or a house;

**Workplace [section 2 (o)]** has been defined as private sector organisation / private venture / undertaking / enterprise / institution / establishment/ society/trust/ non-governmental organisation / unit or service provider and places visited by employee (arising out of or during the course of employment, including transportation provided by employer for undertaking

journey). Hence, if harassment takes place even during transportation or during a lunch meeting at a restaurant, the same will be covered under the Act.

In the case of **Saurabh Kumar Mallick v. Comptroller & Auditor General of India,** the respondent who was facing departmental inquiry for allegedly indulging in sexual harassment of his senior woman officer contended that he could not be accused of sexual harassment at workplace as the alleged misconduct took place not at the workplace but at an official mess where the woman officer was residing.

It was also argued that the complainant was even senior to the respondent and therefore no 'favour' could be extracted by the respondent from the complainant and thus the alleged act would not constitute 'sexual harassment'. The Delhi Court while considering this matter held this as 'clearly misconceived'.

The Delhi Court observed that 'the aim and objective of formulating the Vishaka Guidelines was obvious in order to ensure that sexual harassment of working women is prevented and any person guilty of such an act is dealt with sternly. Keeping in view the objective behind the judgment, a narrow and pedantic approach cannot be taken in defining the term 'workplace' by confining the meaning to the commonly understood expression "office". It is imperative to take into consideration the recent trend which has emerged with the advent of computer and internet technology and advancement of information technology. A person can interact or do business conference with another person while sitting in some other country by way of videoconferencing. It has also become a trend that the office is being run by CEOs from their residence.

In a case like this, if such an officer indulges in an act of sexual harassment with an employee, say, his private secretary, it would not be open for him to say that he had not committed the act at 'workplace' but at his 'residence' and get away with the same. Noting the above, the High Court observed that the following factors would have bearing on determining whether the act has occurred in the 'workplace':

- Proximity from the place of work;
- Control of the management over such a place/residence where the working woman is residing; and
- Such a residence has to be an extension or contiguous part of the working place.

In conclusion, the Delhi High Court held that the official mess where the employee was alleged to have been sexually harassed definitely falls under 'workplace'.

## COMPLAINTS COMMITTEE

The Act provides for two kinds of complaints mechanisms:

(i) Internal Complaints Committee (ICC); and
(ii) Local Complaints Committee (LCC).

### Constitution Internal Complaints Committee

According to section 4 the Act requires an employer to set up an 'Internal Complaints Committee' ("ICC") at each office or branch, of an organization employing 10 or more employees, to hear and redress grievances pertaining to sexual harassment.

1. **Mandatory constitution of Internal Complaints Committee by order in writing:**

   Every employer of a workplace shall, by an order in writing, constitute a Committee to be known as the "Internal Complaints Committee":

   Provided that where the offices or administrative units of the workplace are located at different places or divisional or sub-divisional level, the Internal Committee shall be constituted at all administrative units or offices.

2. **Composition of the ICC: The Internal Committee shall consist of the following members to be nominated by the employer, namely: —**
   a. **Presiding Officer:** a Presiding Officer who shall be a woman employed at a senior level at workplace from amongst the employees. However, in case a senior level woman employee is not available, the Presiding Officer shall be nominated from other offices or administrative units of the workplace referred to in sub-section.
   b. **Members:** not less than 2 Members from amongst employees preferably committed to the cause of women or who have had experience in social work or have legal knowledge;
   c. **External member:** one member from amongst non-governmental organisations or associations committed to the cause of women or a person familiar with the issues relating to sexual harassment:

      Provided that at least one-half of the total Members so nominated shall be women.

3. **Tenure of office:**

   The Presiding Officer and every Member of the Internal Committee shall hold office for such period, not exceeding 3 years, from the date of their nomination as may be specified by the employer.

4. **Fees of external members:**

   The Member appointed from amongst the non-governmental organisations or associations shall be paid such fees or allowances for holding the proceedings of the Internal Committee, by the employer.

5. **Casual vacancy in the office of Presiding Officer or any member of Internal Committee:** Where the Presiding Officer or any Member of the Internal Committee
   a. contravenes the provisions of section 16; or
   b. has been convicted for an offence or an inquiry into an offence under any law for the time being in force is pending against him; or
   c. he has been found guilty in any disciplinary proceedings or a disciplinary proceeding is pending against him; or
   d. has so abused his position as to render his continuance in office prejudicial to the public interest, such Presiding Officer or Member, as the case may be,

   shall be removed from the Committee and the vacancy so created or any casual vacancy shall be filled by fresh nomination in accordance with the provisions of this section.

In Vidya Akhave ("Petitioner") v. Union of India and Ors. Bombay High Court ("Court") ruled that it would not interfere with an order of punishment passed by the Internal Complaints

Committee ("ICC") in relation to a sexual harassment complaint, unless the order is shockingly disproportionate.

## Constitution of Local Complaints Committee

At the district level, the Government is required to set up a 'Local Complaints Committee' ("LCC") to investigate and redress complaints of sexual harassment:

- from the unorganized sector or
- from establishments where the ICC has not been constituted on account of the establishment having less than 10 employees or
- if the complaint is against the employer.

The LCC has special relevance in cases of sexual harassment of domestic workers or where the complaint is against the employer himself or a third party who is not an employee. The provisions of the Act w.r.t. LCC are as follows:

**(i) Notification of District Officer.**

According to section 5, the Appropriate Government may notify a:

- District Magistrate or
- Additional District Magistrate or
- the Collector or
- Deputy Collector

as a District Officer for every District to exercise powers or discharge functions under this Act.

**(ii) Constitution and jurisdiction of Local Committee**

According to section 6, every District Officer shall constitute in the district concerned, a committee to be known as the "Local Committee" to receive complaints of sexual harassment from establishments where the Internal Committee has not been constituted due to having less than 10 workers or if the complaint is against the employer himself.

The District Officer shall designate one nodal officer:

- in every block, taluka and tehsil in rural or tribal area and
- ward or municipality in the urban area,

to receive complaints and forward the same to the concerned Local Committee within a period of 7 days. The jurisdiction of the Local Committee shall extend to the areas of the district where it is constituted.

**(iii) Composition, tenure and other terms and conditions of Local Committee**

Pursuant to section 7, the Local Committee shall consist of the following members to be nominated by the District Officer, namely: -

a. **a Chairperson** to be nominated from amongst the eminent women in the field of social work and committed to the cause of women;
b. **one Member** to be nominated from amongst the women working in block, taluka or tehsil or ward or municipality in the district;

c. **two Members,** of whom at least one shall be a woman, to be nominated from amongst such non- governmental organisations or associations committed to the cause of women or a person familiar with the issues relating to sexual harassment, which may be prescribed:

   Provided that at least one of the nominees should, preferably, have a background in law or legal knowledge. It is provided further that at least one of the nominees shall be a woman belonging to the Scheduled Castes or the Scheduled Tribes or the Other Backward Classes or minority community notified by the Central Government, from time to time;

d. the concerned officer dealing with the social welfare or women and child development in the district, shall be a member ex officio. [Section 7(1)]

The Chairperson and every Member of the Local Committee shall hold office for such period, not exceeding 3 years, from the date of their appointment as may be specified by the District Officer.

**Removal of any Member of the Local Committee**

Where the Chairperson or any Member of the Local Committee commits any of the following acts, he shall be removed from the committee and the vacancy so created or any casual vacancy shall be filled by fresh nomination in accordance with the provisions of this section:

a. contravenes the provisions of section 16; or
b. has been convicted for an offence or an inquiry into an offence under any law for the time being in force is pending against him; or
c. has been found guilty in any disciplinary proceedings or a disciplinary proceeding is pending against him; or
d. has so abused his position as to render his continuance in office prejudicial to the public interest, such Chairperson or Member, as the case may be.

## Grants and Audit

In accordance with section 8, the Central Government may, after due appropriation made by Parliament by law in this behalf, make to the State Government grants of such sums of money as the Central Government may think fit, for being utilised for the payment of fees or allowances referred to in section 7.

The State Government may set up an agency and transfer the grants so made to that agency. The agency shall pay to the District Officer, such sums as may be required for the payment of fees or allowances referred to section 7.

The accounts of such agency shall be maintained and audited in consultation with the Accountant General of the State and the person holding the custody of the accounts of the agency shall furnish, to the State Government, its audited copy of accounts together with auditors' report thereon.

## COMPLAINT

## Complaint of Sexual harassment

Section 9 of the Act provides for the procedure for filing and hearing of complaints under the Act as follows:

1. Any aggrieved woman may make, in writing, a complaint of sexual harassment at work place to the Internal Committee if so constituted, or the Local Committee, in case it is not so constituted, within a period of 3 months from the date of incident and in case of a series of incidents, within a period of 3 months from the date of last incident:

   Provided that where such complaint cannot be made in writing, the Presiding Officer or any Member of the Internal Committee or the Chairperson or any Member of the Local Committee, as the case may be, shall render all reasonable assistance to the woman for making the complaint in writing:

   Provided further that the Internal Committee or, as the case may be, the Local Committee may, for the reasons to be recorded in writing, extend the time limit not exceeding 3 months, if it is satisfied that the circumstances were such which prevented the woman from filing a complaint within the said period.

2. Where the aggrieved woman is unable to make a complaint on account of her physical or mental incapacity or death or otherwise, her legal heir or such other person as may be prescribed may make a complaint under this section.

   Prompt reporting of an act of sexual harassment is probably as important as swift action to be taken by the authorities on receiving a complaint. In fact, the more prompt the complaint is, the more authentic can it be treated.

   In Manjeet Singh vs. Indraprastha Gas Limited 236 (2017) DLT 396, the Delhi High Court observed that anonymous complaints under the Act are bound to be rejected.

   The written complaint should contain a description of each incident(s). It should include relevant dates, timings and locations; name of the respondent(s); and the working relationship between the parties. A person designated to manage the workplace sexual harassment complaint is required to provide assistance in writing of the complaint if the complainant seeks it for any reason.

## CONCILIATION

According to section 10, the Internal Committee or, as the case may be, the Local Committee, may, before initiating an inquiry under section 11 and at the request of the aggrieved woman, take steps to settle the matter between her and the respondent through conciliation. It is provided that no monetary settlement shall be made as a basis of conciliation.

Where a settlement has been so arrived, the Internal Committee or the Local Committee, as the case may be, shall record the settlement so arrived and forward the same to the employer or the District Officer to take action as specified in the recommendation. The Internal Committee or the Local Committee, as the case may be, shall provide the copies of the settlement so recorded to the aggrieved woman and the respondent. No further inquiry shall be conducted by the Internal Committee or the Local Committee, as the case may be in case where such settlement is arrived.

## Inquiry into Complaint

Section 11 of the Act states the procedure for conducting inquiry into the complaint made under the Act. Subject to the provisions of section 10, the Internal Committee or the Local Committee, as the case may be, shall, where the respondent is an employee, proceed to make inquiry into the complaint in accordance with the provisions of the service rules applicable to the respondent and

where no such rules exist, in such manner as may be prescribed or

in case of a domestic worker, the Local Committee shall, if prima facie case exist, forward the complaint to the police, within a period of 7 days for registering the case under section 509 of the Indian Penal Code, and any other relevant provisions of the said Code where applicable.

It is provided that where the aggrieved woman informs the Internal Committee or the Local Committee, as the case may be, that any term or condition of the settlement arrived at under section 10(2) has not been complied with by the respondent, the Internal Committee or the Local Committee shall proceed to make an inquiry into the complaint or, as the case may be, forward the complaint to the police.

It is provided further that where both the parties are employees, the parties shall, during the course of inquiry, be given an opportunity of being heard and a copy of the findings shall be made available to both the parties enabling them to make representation against the findings before the Committee.

The POSH Act stipulates that the ICC and LCC shall, while inquiring into a complaint of workplace sexual harassment, have the same powers as vested in a civil court under the Code of Civil Procedure, 1908 when trying a suit in respect of: -

a. summoning and enforcing the attendance of any person and examining him on oath;
b. requiring the discovery and production of documents; and
c. any other matter which may be prescribed.

Such an inquiry shall be completed within a period of 90 days.

## Action during pendency of inquiry

Section 12 provides for the relief that can be given by IC to the aggrieved woman during pendency of inquiry. During the pendency of an inquiry, on a written request made by the aggrieved woman, the Internal Committee or the Local Committee, as the case may be, may recommend to the employer to —

a. transfer the aggrieved woman or the respondent to any other workplace; or
b. grant leave to the aggrieved woman up to a period of three months; or
c. grant such other relief to the aggrieved woman as may be prescribed.

The leave granted to the aggrieved woman under this section shall be in addition to the leave she would be otherwise entitled.

On such recommendation of the Internal Committee or the Local Committee, as the case may be, the employer shall implement the recommendations so made and send the report of such implementation to the Internal Committee or the Local Committee, as the case may be.

## Inquiry Report

Section 13 of the Act provides for the action report to be submitted by IC or LC after conducting inquiry under the Act. On the completion of an inquiry under this Act, the Internal Committee or the Local Committee, as the case may be, shall provide a report of its findings to the employer, or as the case may be, the District Officer within a period of 10 days from the date of completion of the inquiry and such report be made available to the concerned parties.

Where the Internal Committee or the Local Committee, as the case may be, arrives at the conclusion that the allegation against the respondent has not been proved, it shall recommend to the employer and the District Officer that no action is required to be taken in the matter.

Where the Internal Committee or the Local Committee, as the case may be, arrives at the conclusion that the allegation against the respondent has been proved, it shall recommend to the employer or the District Officer, as the case may be –

i. to take action for sexual harassment as a misconduct;
ii. to deduct, notwithstanding anything in the service rules applicable to the respondent, from the salary or wages of the respondent such sum as it may consider appropriate to be paid to the aggrieved woman or to her legal heirs, as it may determine, in accordance with the provisions of section 15.

It is provided that in case the employer is unable to make such deduction from the salary of the respondent due to his being absent from duty or cessation of employment it may direct to the respondent to pay such sum to the aggrieved woman.

It is provided further that in case the respondent fails to pay the sum referred to in clause (ii), the Internal Committee or, as the case may be, the Local Committee may forward the order for recovery of the sum as an arrear of land revenue to the concerned District Officer.

The employer or the District Officer shall act upon the recommendation within 60 days of its receipt by him.

## Punishment for false or malicious complaint and false evidence

There are strict provisions under section 14 of the Act for false or malicious complaint and false evidence under the Act. Where the Internal Committee or the Local Committee, as the case may be, arrives at a conclusion that:

- the allegation against the respondent is malicious or
- the aggrieved woman or any other person making the complaint has made the complaint knowing it to be false or
- the aggrieved woman or any other person making the complaint has produced any forged or misleading document,

it may recommend to the employer or the District Officer, as the case may be, to take action against the woman or the person who has made the complaint under section 9, as the case may be, in accordance with the provisions of the service rules applicable to her or him or where no such service rules exist, in such manner as may be prescribed.

It is provided that a mere inability to substantiate a complaint or provide adequate proof need not attract action against the complainant under this section. It is provided further

that the malicious intent on part of the complainant shall be established after an inquiry in accordance with the procedure prescribed, before any action is recommended.

Where the Internal Committee or the Local Committee, as the case may be, arrives at a conclusion that during the inquiry any witness has given false evidence or produced any forged or misleading document, it may recommend to the employer of the witness or the District Officer, as the case may be, to take action in accordance with the provisions of the service rules applicable to the said witness or where no such service rules exist, in such manner as may be prescribed.

## Determining of Compensation

Section 15 provides that for the purpose of determining the sums to be paid to the aggrieved woman section 13, the Internal Committee or the Local Committee, as the case may be, shall have regard to:

a. the mental trauma, pain, suffering and emotional distress caused to the aggrieved woman;
b. the loss in the career opportunity due to the incident of sexual harassment;
c. medical expenses incurred by the victim for physical or psychiatric treatment;
d. the income and financial status of the respondent;
e. feasibility of such payment in lump sum or in instalments.

## Prohibition of publication or making known contents of complaint and inquiry proceedings

According to section 16, notwithstanding anything contained in the Right to Information Act, 2005, the contents of the complaint made under section 9:

- the identity and addresses of the aggrieved woman, respondent and witnesses,
- any information relating to conciliation and inquiry proceedings,
- recommendations of the Internal Committee or the Local Committee, as the case may be, and
- the action taken by the employer or the District Officer under the provisions of this Act

shall not be published, communicated or made known to the public, press and media in any manner.

It is provided that information may be disseminated regarding the justice secured to any victim of sexual harassment under this Act without disclosing the name, address, identity or any other particulars calculated to lead to the identification of the aggrieved woman and witnesses.

## Penalty for publication or making known contents of complaint and inquiry proceedings

According to section 17, where any person entrusted with the duty to handle or deal with the complaint, inquiry or any recommendations or action to be taken under the provisions of this Act, contravenes the provisions of section 16, he shall be liable for penalty in accordance with the provisions of the service rules applicable to the said person or where no such service rules exist, in such manner as may be prescribed.

## APPEAL

Section 18 provides for the appeal by aggrieved person under the Act. Any person aggrieved from the recommendations made under:

- section 13(2) or
- section 13(1)(i)(ii) or
- section 14(1)(2) or
- section 17 or
- non-implementation of such recommendations

may prefer an appeal to the court or tribunal

- in accordance with the provisions of the service rules applicable to the said person or
- where no such service rules exist then, without prejudice to provisions contained in any other law for the time being in force,

the person aggrieved may prefer an appeal.

Such appeal shall be preferred within a period of 90 days of the recommendations.

## DUTIES OF EMPLOYER (Section 19)

Such duties begin at the time when an employer has to set up an internal complaints committee to ensure that aggrieved can file their complaints and seek redressal to such complaints and end at the time when the employer has provided certain data, in accordance with the provisions of the law, in relation to sexual harassment in its annual report.

According to the section, every employer shall —

a. provide a safe working environment at the workplace which shall include safety from the persons coming into contact at the workplace;
b. display at any conspicuous place in the workplace, the penal consequences of sexual harassments; and the order constituting, the Internal Committee;
c. organise workshops and awareness programmes at regular intervals for sensitising the employees with the provisions of the Act and orientation programmes for the members of the Internal Committee;
d. provide necessary facilities to the Internal Committee or the Local Committee for dealing with the complaint and conducting an inquiry;
e. assist in securing the attendance of respondent and witnesses before the Internal Committee or the Local Committee;
f. provide assistance to the woman if she so chooses to file a complaint in relation to the offence under the Indian Penal Code 1860 or any other law for the time being. in force;
g. cause to initiate action, under the Indian Penal Code 1860 or any other law for the time being in force, against the perpetrator, or if the aggrieved woman so desires, where the perpetrator is not an employee, in the workplace at which the incident of sexual harassment took place;
h. treat sexual harassment as a misconduct under the service rules and initiate action for such misconduct;
i. monitor the timely submission of reports by the Internal Committee.

### Duties and Powers of Districts Officer

Section 20 cast upon the following mandatory duties on the District Officer who shall, —

a. monitor the timely submission of reports furnished by the Local Committee;
b. take such measures as may be necessary for engaging non-governmental organisations for creation of awareness on sexual harassment and the rights of the women.

## MISCELLANEOUS

### Committee to submit annual report

According to section 21, the Internal Committee or the Local Committee, as the case may be, shall in each calendar year prepare an annual report and submit the same to the employer and the District Officer.

The District Officer shall forward a brief report on the annual reports so received to the State Government.

### Employer to include information in annual report

According to section 22, the employer shall include in its report the number of cases filed, if any, and their disposal under this Act in the annual report of his organisation or where no such report is required to be prepared, intimate such number of cases, if any, to the District Officer.

### Appropriate Government to monitor implementation and maintain data

Pursuant to the provisions of section 23, the appropriate Government shall monitor the implementation of this Act and maintain data on the number of cases filed and disposed of in respect of all cases of sexual harassment at workplace.

### Appropriate Government to take measures to publicise the Act

In accordance with section 24, the appropriate Government may, subject to the availability of financial and other resources:

a. develop relevant information, education, communication and training materials, and organise awareness programmes, to advance the understanding of the public of the provisions of this Act providing for protection against sexual harassment of woman at workplace,
b. formulate orientation and training programmes for the members of the Local Committee.

### Poser to call for information and inspection of records

Section 25 lists out the power of the appropriate Government under the Act.

The appropriate Government, on being satisfied that it is necessary in the public interest or in the interest of women employees at a workplace to do so, by order in writing, —

a. call upon any employer or District Officer to furnish in writing such information relating to sexual harassment as it may require;
b. authorise any officer to make inspection of the records and workplace in relation to sexual harassment, who shall submit a report of such inspection to it.

Every employer and District Officer shall produce on demand before the officer making the inspection all information, records and other documents in his custody having a bearing on the subject matter of such inspection.

## Penalty for non-compliance with provisions of Act

Section 26 provides for a penalty with a fine up to Rs. 50,000 where the employer fails to:

a. constitute an Internal Committee;
b. take action under sections 13, 14 and 22; and
c. contravenes or attempts to contravene or abets contravention of other provisions of this Act or any rules made there under.

If any employer, after having been previously convicted of an offence punishable under this Act subsequently commits and is convicted of the same offence, **he shall be liable to twice the punishment,** which might have been imposed on a first conviction, subject to the punishment being maximum provided for the same offence.

In addition to above, he shall be liable for cancellation, of his licence or withdrawal, or non-renewal, or approval, or cancellation of the registration, by the Government or local authority, as the case may be, for carrying on his business or activity.

## Cognizance of offence by courts

According to section 27, every offence under this Act is non-cognizable which means one cannot be arrested without a warrant.

No court shall take cognizance of any offence punishable under this Act or any rules made there under, save on a complaint made by the aggrieved woman or any person authorised by the Internal Committee or Local Committee in this behalf.

No court inferior to that of a Metropolitan Magistrate or a Judicial Magistrate of the first class shall try any offence punishable under this Act.

## Act not in derogation of any other law

Section 28 states that the purpose of the Act is to provide additional safeguard to women at work. According to the section, the provisions of this Act shall be in addition to and not in derogation of the provisions of any other law for the time being in force.

## Power of appropriate Government to make rules

In exercise of the powers conferred by section 29 of the Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013, the Central Government made the Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Rules, 2013.

## CASE LAWS

**Binoy Jacob vs. State of Kerala and Ors. (2022 - KERHC)**

In this case, petition has been filed to quash the proceedings on the ground that since the very same complaint raised by the 2nd respondent considered by the Internal Complaints Committee and found to be not proved, the criminal prosecution on same set of facts before a court will not stand. Court held that

"Section 28 of the Act of 2013 stipulates that provisions of the Act shall be in addition to and not in derogation of the provisions of any other law for the time being in force. Thus, it is clear that the action under the Act of 2013 by the employer and a complaint registered at the instance of the employee for the offence under the Indian Penal Code is independent to each other. Two-fold actions are permissible for the sexual harassment complaint. Hence, both actions are independent and permissible under law. There is absolutely no bar in proceeding with the criminal prosecution initiated against the petitioner."

**Rayala Satyanarayana vs. SBI Funds Management Pvt. Ltd. and Ors. (2022-APHC)**

In this case, Andhra Pradesh High Court decided on whether the termination of services is, in fact, a major punishment, which cannot be imposed without conducting a separate departmental enquiry or without affording an opportunity of hearing or issuing a separate charge memo. Court held that Conclusions by Committee cannot be the basis for imposing a major penalty of removal from service, because it is a finding/report in an enquiry into the misconduct of the delinquent and cannot be treated as a mere preliminary investigation or inquiry leading to a disciplinary action. Court stated-

"the conclusions arrived at by the Committee cannot be the basis for imposing a major penalty of removal from service, mainly on the ground that the conclusions arrived at by the Committee shall not be treated as a mere preliminary investigation or inquiry leading to a disciplinary action, but shall be treated as a finding/report in an enquiry into the misconduct of the delinquent."

The impugned proceedings further suffer from severe illegality as the said proceedings were issued without there being any regular departmental enquiry and without giving any opportunity as per the Service Rules, which mandate that initiation of disciplinary proceedings is a mandatory requirement and without conducting any enquiry, no employee can be imposed any major penalties.