BLOGS

Passage-Based Test on Company Law for CLAT PG

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Passage I

Tax avoidance and tax evasion are two expressions which find no definition either in the Indian Companies Act, 1956 or the Income Tax Act, 1961. But the expressions are being used in different contexts by our Courts as well as the Courts in England and various other countries, when a subject is sought to be taxed. One of the earliest decisions which came up before the House of Lords in England demanding tax on a transaction by the Crown is Duke of Westminster (supra). In that case, Duke of Westminster had made an arrangement that he would pay his gardener an annuity, in which case, a tax deduction could be claimed.

Wages of household services were not deductible expenses in computing the taxable income, therefore, Duke of Westminster was advised by the tax experts that if such an agreement was employed, Duke would get tax exemption. Under the Tax Legislation then in force, if it was shown as gardener’s wages, then the wages paid would not be deductible. Inland Revenue contended that the form of the transaction was not acceptable to it and the Duke was taxed on the substance of the transaction, which was that payment of annuity was treated as a payment of salary or wages.

Crown’s claim of substance doctrine was, however, rejected by the House of Lords. Lord Tomlin’s celebrated words are quoted below:

“Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax.

This so called doctrine of ‘the substance’ seems to me to be nothing more than an attempt to make a man pay notwithstanding that he has so ordered his affairs that the amount of tax sought from him is not legally claimable.”

Lord Atkin, however, dissented and stated that “the substance of the transaction was that what was being paid was remuneration.”

The principles which have emerged from that judgment are as follows:

(1) A legislation is to receive a strict or literal interpretation;

(2) An arrangement is to be looked at not by its economic or commercial substance but by its legal form; and

(3) An arrangement is effective for tax purposes even if it has no business purpose and has been entered into to avoid tax.

(Extract from Vodafone International Holdings B.V. vs Union of India & Anr., 2012 (6) SCC 757)

Q1. The Honourable Supreme Court of India recognised the juristic personality of a company as distinct from its shareholders in:

a. Bacha F. Guzdar v. CIT, Bombay

b. State Trading Corporation of India v. Commercial Tax Officer

c. Life Insurance Corporation of India v. Escorts Ltd.

d. Saloman v. Saloman Co. Ltd.

Q2. Which of the following sections of the Companies Act, 2013 is related to the lifting of the corporate veil?

a. Section 339

b. Section 330

c. Section 229

d. Section 335

Q3. Which of the following statements correctly distinguishes tax evasion from tax avoidance?

a. While tax avoidance is illegal, tax evasion is legitimate tax planning.

b. While tax avoidance entails setting up legal arrangements, tax evasion entails fraud or concealment.

c. Both tax evasion and tax avoidance are criminal offences

d. Tax avoidance is punishable with imprisonment, whereas tax evasion is not

Q4. The theory of the doctrine of lifting of the corporate veil which says that when the company’s owners/directors use its corporate personality for their own benefit instead of using it for the benefit of the company is:

a. The theory of alter ego

b. The instrumentality theory

c. Fiction theory

d. Concession theory

Q5. In which of the following cases did the Supreme Court recognise the doctrine of lifting of the corporate veil?

a. Life Insurance Corporation of India v. Escorts Ltd.

b. Ashbury Railway Carriage & Iron Co. v. Riche

c. Salomon v. Salomon & Co. Ltd.

d. Bacha F. Guzdar v. CIT, Bombay

Passage II

The doctrine of indoor management is in direct contrast to the doctrine or rule of constructive notice, which is essentially a presumption operating in favour of the company against the outsider. It prevents the outsider from alleging that he did not know that the constitution of the company rendered a particular act or a particular delegation of authority ultra vires.

The doctrine of indoor management is an exception to the rule of constructive notice. It imposes an important limitation on the doctrine of constructive notice. According to this doctrine, persons dealing with the company are entitled to presume that internal requirements prescribed in memorandum and articles have been properly observed. Therefore doctrine of indoor management protects outsiders dealing or contracting with a company, whereas doctrine of constructive notice protects the insiders of a company or corporation against dealings with the outsiders.

However suspicion of irregularity has been widely recognized as an exception to the doctrine of indoor management. The protection of the doctrine is not available where the circumstances surrounding the contract are suspicious and therefore invite inquiry. This exception was highlighted in the English case of *J.C. Houghton & Co. v. Nothard, Lowe & Wills Ltd.*, [1927] 1 KB 246 (CA).

(Extract from MRF Ltd. v. Manohar Parrikar, (2010) 11 SCC 374)

Q6. Identify the correct statements:

1. The role of the doctrine of indoor management is opposed to the role of the doctrine of constructive notice.
2. The doctrine of constructive notice protects the company against outsiders.
3. The doctrine of indoor management protects outsiders against the actions of the company.

a. I and II

b. II and III

c. II only

d. All of the above

Q7. Which of the following statements are incorrect regarding the rule of indoor management?

a. The rule will not apply where the outsider had knowledge of irregularity

b. The rule can be invoked if there is no knowledge of memorandum and articles

c. The doctrine cannot be applied even if the person behaves negligently

d. The doctrine cannot validate transactions relied on a forged document

Q8. The Doctrine of Indoor Management was laid down for the first time in:

a. Salomon v. Salomon & Co. Ltd.

b. Royal British Bank v. Turquand

c. Foss v. Harbottle

d. Ashbury Railway Carriage v. Riche

Q9. Which of the following best describes the legal fiction under the doctrine of constructive notice?

a. It is assumed that outsiders are aware of every internal resolution.

b. It is assumed that registered public documents have been read by outsiders.

c. Directors are required to disclose all restrictions to outsiders.

d. Company representations are dependable to outsiders.

Q10. Which of the following documents give rise to the Doctrine of Constructive Notice?

a. Prospectus

b. Memorandum of Association only

c. Articles of Association only

d. Memorandum and Articles of Association

Passage III

The offence under Section 448 of the Companies Act is an 'offence covered under Section 447' as mentioned in Section 212(6) of the Companies Act and therefore, the bar against taking cognizance under the second proviso of Section 212(6) of the Companies Act, unless specific conditions are met, is attracted in the present case. Cognizance, therefore, in such a case, cannot be taken merely by filing of a private complaint by the Complainant.

However, it is not to say that the Complainant is left absolutely remediless. The right recourse for a person, who makes an allegation of fraud in the affairs of a company is to file an application under Section 213 of the Companies Act before the NCLT upon satisfying the eligibility under Section 213(a) and 213(b) of the Companies Act.

(Extract from Yerram Vijay Kumar v. State of Telangana & Anr., 2026 SC)

Q11. Under the Companies Act, 2013, for any offense of corporate fraud, no court shall take cognizance except on a complaint made by:

a. The Director, SFIO

b. Any officer of the Central Government

c. SFIO or Any officer of Central Government

d. NCLT

Q12. The extent to which a company, as a legal entity, may be prosecuted for its own actions and inactions, as well as those of the natural persons it employs is known as:

a. Lifting the corporate veil

b. Vicarious criminal liability

c. Alter ego principle

d. Corporate criminal liability

Q13. Which provision gives the National Company Law Tribunal (NCLT) the authority to order an inquiry into the affairs of a company upon a member's application?

a. Section 210

b. Section 211

c. Section 212

d. Section 213

Q14. In accordance with the Companies Act of 2013, the Central Government may mandate an inquiry into the affairs of a company upon receiving a report from the Registrar under:

a. Section 206

b. Section 210

c. Section 212

d. Section 213

Q15. Assertion: Private individuals cannot file criminal complaints for offenses related to fraud under the Companies Act, 2013.
Reason: Cognizance of such offenses can only be taken by a Special Court upon a complaint filed by the Director of the Serious Fraud Investigation Office (SFIO) or an officer authorized by the Central Government.

a. Both A and R are true, and R is the correct explanation of A

b. Both A and R are true, but R is not the correct explanation of A

c. A is true, but R is false

d. A is false, but R is true

Answers

1. (A) In Bacha F. Guzdar v. Commissioner of Income Tax, the Supreme Court ruled that only corporations, not shareholders, are eligible for a 60% tax exemption. A share is a right to take part in the business's operations while it is a going concern, and shareholders are separate entities from the corporation.
2. (A) Section 339 gives the National Company Law Tribunal the authority to hold anyone accountable for fraud if they conduct business for the company with the intention of defrauding creditors or for any other fraudulent purpose while the firm is being wound up.
3. (B) While tax avoidance uses lawful strategies within the confines of the law to reduce tax liabilities, tax evasion uses criminal measures.
4. (B) Indian courts apply the principle of piercing or lifting the corporate veil based on two theories.The theory of alter ego states that there is unity of interest between the company and its owners and that the company's separate legal existence has ceased when the distinction between the company and its owners becomes hazy and the company simply acts as the owners' alter ego for engaging in illegal activities.When a corporation is separated from its

owners, the owner’s illicit activities become apparent.The instrumentality theory states that when a company’s owners or directors use its corporate identity for personal gain rather than the company’s advantage,

5. (A) The Hon’ble Supreme Court acknowledged the concept of piercing the corporate veil in Life Insurance Corporation of India v. Escorts Ltd. and noted that a corporate entity’s veil may be pierced when a law specifically permits it, when fraud or improper behaviour is sought to be avoided, when a tax statute is attempted to be circumvented, or when related entities are closely related and, in fact, part of one concern. Listing the kinds of situations where piercing the veil is permissible is neither necessary nor desirable, as this would unavoidably depend on the legislation, its purpose, the alleged behaviour, the impact on potentially impacted parties, the public interest component, etc.
6. (D) It is important to emphasise that the concept of constructive notice is an exception to the indoor management principle and that it does not give outsiders access to information about the company’s internal operations. The Doctrine of Indoor Management, often known as “The Turquand Rule,” states that if a MOA or AOA accepts an act, an outsider can assume that all the formalities are fulfilled in carrying out the act. The Royal British Bank v. Turquand (1856), 6 E&B 327, a landmark case, serves as the foundation for this. The doctrine of indoor management, to put it simply, says that the company’s indoor issues are its responsibility.
7. (B) Knowledge of irregularity, forgery, negligence are exceptions to the doctrine of indoor management. While no knowledge of memorandum and articles of association does not constitute a ground for exemption to the doctrine of indoor management.
8. (B)
9. (B)
10. (D)
11. (C) According to Section 212(6), no court may take cognisance of any offence covered by Section 447 (which defines and sanctions corporate fraud) unless the Director, SFIO, or other Central Government officer authorised by a general or special order files a complaint. Section 213 of the Companies Act provides a remedy for anyone who suspects fraud in a company’s management. The National Company Law Tribunal (NCLT) must be contacted. The NCLT has the authority to order the SFIO or the Central Government to conduct an investigation if it is convinced that one is necessary. The authorised officer may only properly file a criminal complaint if that inquiry proves the fraud.

12. (D)
13. (D) When members (at least 100 or 10% voting power) or the Central Government suspect fraud, misconduct (misfeasance, misappropriation, etc.), or a fraudulent/unlawful purpose, Section 213 of India’s Companies Act, 2013 gives the National Company Law Tribunal (NCLT) the authority to order an investigation into a company’s affairs. This allows for the discovery of deceit, protects stakeholders, and may result in penalties under Section 447 for fraud.
14. (B) In order to ensure transparency and protect stakeholders, Section 210 of the Companies Act, 2013 permits the Central Government to order an investigation into a company’s affairs when it is in the public interest, based on a report from a Registrar or Inspector, or when a court or tribunal requires it. This allows inspectors to be appointed to report on possible fraud, misconduct, or unlawful activities.
15. (A) Private individuals cannot file criminal complaints for offenses related to fraud under the Companies Act, 2013 as held in Yerram Vijay Kumar v. State of Telangana & Anr., (2026), cognizance of such offenses can only be taken by a Special Court upon a complaint filed by the Director of the Serious Fraud Investigation Office (SFIO) or an officer authorized by the Central Government.