

## DECIPHERING SECTION 4 (7) OF THE COMPANIES ACT, 1956

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The Section 4 of the Companies Act, 1956 (herein after referred to as "Act") relates to the "Meaning of 'Holding Company and Subsidiary' ". The Section 4 (7) of the Act was inserted by the Companies (Amendment) Act, 1960 and it states as follows:-

*"A private company, being a subsidiary of a body corporate incorporated outside India, which, if incorporated in India, would be a public company within the meaning of this Act, shall be deemed for the purposes of this Act to be a subsidiary of a public company if the entire share capital in that private company is not held by that body corporate whether alone or together with one or more other bodies corporate incorporated outside India."*

In order to understand the significance and importance of Section 4 (7) of the Act, let us try to interpret it along with few case studies, as follows:-

**Part 1 of Section 4 (7) of the Act:** *"A private company, being a subsidiary of a body corporate incorporated outside India, which, if incorporated in India, would be a public company within the meaning of this Act"*

(1) This part of the sub section intends to identify the status (Public or Private) of a Body Corporate, if it (i.e. the Body Corporate) had been incorporated in India in accordance with the Indian Companies Act.

(2) Therefore, the crucial factor in determining the status of the Body Corporate is which of the provisions are complied with. i.e. Section 3 (1) (iii) (Definition of Private Limited Company) or Section 3 (1) (iv) of the Act (Definition of Public Company).

(3) If the Body Corporate satisfies all the Four (4) conditions of a Private Limited Company like restrictions on right to transfer shares, limits the number of members, prohibits any invitation to public to subscribe for any shares and prohibits any invitation / acceptance of deposits; then the "Body Corporate" would be a "Private Limited Company" in accordance with the Act.

(4) As a part of compliance; the Company Secretary shall meticulously and thoroughly read the Memorandum of Association / Articles of Association / any other integral Incorporation Documents of the Body Corporate (i.e. a Company incorporated outside India) to understand the status, whether private or

public; in accordance the Act. If the Incorporation documents do not satisfy all the necessary conditions prescribed under Section 3 (1) (iii) of the Act; then the "Body Corporate" would be treated as "Public Company" in accordance with the Act.

**Part 2 of Section 4 (7) of the Act:** *"shall be deemed for the purposes of this Act to be a subsidiary of a public company if the entire share capital in that private company is not held by that body corporate whether alone or together with one or more other bodies corporate incorporated outside India."*

(1) The next fundamental test which is an important part of Part 2 is the shareholding pattern in the Private Limited Company.

(2) The Sub Section negatively states that if the entire share capital is not held by a Body Corporate incorporated outside India (whether alone or together); then the private company shall be deemed to be a subsidiary of Public Company.

(3) Now, if the Part 2 of the Sub Section is read in an affirmative manner, it can be interpreted as; the Private Company retains its status as a "Private Company" (as defined under Section 3 (1) (iii) of the Act), if and only if the entire share capital is held by a Body Corporate (s) incorporated outside India (whether alone or together).

The effect of Section 4 (7) of the Act is:-

(1) An Indian Private Limited Company will retain its status as "Private Limited Company", if its entire share capital is held by Foreign Body Corporate (s).

(2) An Indian Private Limited Company would be "deemed to be a Subsidiary of Public Company", if it's entire share capital is not held by Foreign Body Corporate (s) (i.e. less than 100%).

It is also worth noting that Section 4 (7) of the Act includes the words "the entire share capital in that private company". The word "Share Capital" includes Equity and Preference Share Capital. It does not mention Equity Share Capital or Preference Share Capital or Voting Capital.

With reference to the above discussion; the following examples will bring more clarity to the subject:- For the sake of brevity, "Foreign Body Corporate" is referred to as "F" and Indian Private Limited Company is referred to as "I".

Sr. No.	Case Study	Assumption for the purpose of the Case Study	Status of "I" in accordance with Section 4 (7) of the Act.	Reasons for the conclusion
1	"F" holds 80% of the Share Capital in "I"	"F" had it been incorporated in India; would be a Private Limited Company.	"I" would retain the status of Private Limited Company.	"F" is not a Public Company (had it been incorporated in India). <i>This is because "F" does not hold entire share capital of "I".</i>
2	"F" holds 80% of the Share capital of "I".	"F" had it been incorporated in India; would be a Public Company.	"I" would be a Subsidiary of a Public Company and would not retain the status of "Private Limited Company".	"F" is a Public Company (had it been incorporated in India). <i>This is because "F" does not hold entire share capital of "I".</i>
3	"F" holds 99.99% of the Share capital in "I" & remaining .01% of the Share capital is held by the Nominee of "F".	"F" had it been incorporated in India; would be a Public Limited Company.	"I" continues to retain the status of a Private Limited Company.	"F" is a Public Company (had it been incorporated in India) and holds the entire share capital of "I" (in its own name and through a Nominee). "F" & "I" are required to comply with the provisions of Section 187C of the Act with respect to the .01% of the Share Capital of "I" is held by the Nominee of "F".
4	"F" holds 96% of the Share capital and remaining 4% of the Share capital is held by the Resident Individual in "I".	"F" had it been incorporated in India; would be a Public Limited Company.	"I" will become a Subsidiary of Public Company.	"F" does not hold the entire share capital of "I" (96%) as contemplated by Section 4 (7) of the Act; that being one of the critical conditions.
5	"F" holds 96% of the Share capital and remaining 4% of the Share capital is held by "Mr. X Jointly with a Non Resident Individual (NRI)". Mr. X is a Nominee of "F"	"F" had it been incorporated in India; would be a Public Limited Company.	"I" continues to retain the status of a Private Limited Company.	"F" is a Public Company (had it been incorporated in India) and holds the entire share capital of "I" (in its own name and through a Nominee). "F" & "Mr. X" are required to comply with the provisions of Section 187C of the Act with respect to the 4% of the Share Capital of "I" is held by the Nominee of "F" i.e. Mr. X.
6	F1, F2 and F3 have entered into a Joint Venture Agreement and incorporate "I". The Share holding pattern "I" of is as follows:- F1 = 33.33%, F2 = 33%,	F1, F2 and F3 all three of them, had they been incorporated in India would be Public Companies.	"I" retains the status as Private Limited Company	As the entire share capital in "I" is held by together by F1, F2 and F3. For the purpose of this case, the relevant part of Section 4 (7) is " <i>..... together with one or more other bodies corporate incorporated outside India</i> ".
7	"F" holds less than 50% of the Share capital and remaining is held by the Resident Individual in "I".	"F" had it been incorporated in India; would be a Public Limited Company.	"I" retains the status as Private Limited Company	"F" does not hold the entire share capital of "I"; that being one of the critical conditions.

From the above discussion and few examples, following are the Two (2) essential conditions that that one must ascertain while applying the provisions of Section 4 (7) of the Act: -

- (1) The status of a Foreign Body Corporate; had it been incorporated in India &
- (2) The percentage of shareholding by the Foreign Body Corporate in the Indian Private Limited Company. There is another view in construing the meaning of Section 4 (7) of the Act. Is the Section 4 (7) trying to create confusion by giving birth to another "Type of Company - Subsidiary of Public Company"?

For this purpose, the relevant part of Section 4 (7) of the Act is reproduced as follows:-

"..... would be a public company within the meaning of this Act, shall be deemed for the purposes of this Act to be a subsidiary of a public company if ....."

The concept of "Subsidiary of a Public Company" has invariably been applied in the Act. i.e. Example: Section 90 (2), 269 (1), 300 (2) (b) and 372 (A) (8) (a) (iii) of the Act. Can the necessary references in the Act deleted given with respect to the "concept".

For the purpose of resolving the above mentioned confusion of concept "Subsidiary of a Public Company", in my view, we need to refer to Section 3 (1) (iv) (c) of the Act to do away with confusion.

Section 3 (1) (iv) (c) of the Act defines a Public Company as "a private company which is a subsidiary of a company which is not a private company."

Further, if an Indian Private Limited Company ("I"), by virtue of Section 4 (7) of the Act, deems to be a subsidiary of public company; then is "I" required to amend its Articles of Association with respect to minimum number of members, limitation on the number of members, prohibits any invitation to public to subscribe for any shares and prohibits any invitation / acceptance of deposits, name of company etc.?

In my view, since "I" is deemed for the purposes of this Act as a Subsidiary of a Public Company and hence it is not necessary for "I" to undertake the above activities and amend its Articles of Association. The basic structure of "I" continues to remain the same as Private Limited Company; but it is then necessary to comply with the provisions of the "Subsidiary of a Public Company" as laid down by the Act.

This Sub Section is invariably taken into consideration at the time of investment by foreign entities in closely held Indian Private Limited Companies through strategic route or joint venture.

At the time considering the implication of Section 4 (7) of the Act in a particular case / situation; one shall also ensure compliance of Tax Laws and Foreign Exchange Management Regulations.