Magazine

VOLUME 121/1

COMPANY LAW

[2014] 121 CLA (Mag.) 1

Absurdities in definitions of 'holding company' and 'subsidiary company'

Gaurav Pingle*

Holding-subsidiary relationship is the very basic relationship in defining companies as a part of a particular group of companies. In the Companies Act, 2013, there has been a sea change in the definitions of 'holding company' and 'subsidiary company'. Section 4, being the corresponding provision of the Companies Act, 1956, has significantly been changed and incorporated as two separate sections in the Companies Act, 2013. The author analyses the definitions of 'holding company' and 'subsidiary company', anomalies in the definition and the solution for rectifying such anamolies.

❖❖EFW❖❖

Definition of 'subsidiary company'

1. Clause (87) of section 2 of the Companies Act, 2013 ('the Act') defines 'subsidiary company' or 'subsidiary', in relation to any other company (that is to say the holding company) to mean 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 total share capital either at its own or together with one or more of its subsidiary companies

Anomaly 1

1.1 There seems to be a drafting error in sub-clause (*ii*) of clause (*87*) of section 2 as it states that "exercise or control more than one-half of total share capital.....". For any company, it is practically difficult to exercise one half of total share capital. A company or person can exercise voting rights and not capital as a whole. To rectify this anomaly, it is suggested to amend sub-clause (*ii*) by deleting the phrase "exercise one half of total share capital"; as the member of the company exercises voting and not share capital and to substitute words 'total share capital' by 'total equity capital' or revert back to the provisions of section 4 of the Companies Act, 1956 ('1956 Act')

* Corporate Advisory Services (P.) Ltd.

Anomaly 2

1.1.2 World over, holding - subsidiary relationship is defined by holding equity shares/voting powers emanating from equity shares. In sub-clause (*ii*) of clause (*87*) of section 2 the phrase used is 'one half of total share capital'. Usually, preference shares are issued as a part of strategic investment in company and preference shares do not carry voting rights for all resolutions. To rectify this anomaly, it is suggested to substitute words 'total share capital' by 'total equity capital' or revert back to the provisions of section 4 of the 1956 Act.

Anomaly 3

1.1.3 'Total share capital' has been defined in rule 2(*r*) of the Companies (Specification of Definitions Details) Rules, 2014 to mean the aggregate of the paid-up equity share capital and convertible preference share capital. This definition further compounds the confusion as convertible preference shares to be a part of share capital and "non-convertible preference shares" not to be a part of 'share capital'. To remove this anomaly, it is suggested that the words 'total share capital' be substituted by the words 'total equity capital' or revert back to the provisions of section 4 of the 1956 Act.

Anomaly 4

1.1.4 'Subsidiary company' has been defined in relation to any other company (that is to say the holding company) to mean a company in which the holding company exercises or controls more than one-half of the total share capital *either at its own or together with one or more of its subsidiary companies*. This leads to confusion regarding the calculation of shareholding in a company which can be better explained by an example : A Ltd. holds 70 per cent of share capital of B Ltd. and A Ltd. holds 40 per cent of share capital of C Ltd. Now, B Ltd. holds 12 per cent of share capital of C Ltd. In this backdrop the question arises whether to aggregate the shareholding in C Ltd. of A Ltd (40 per cent) and B Ltd. (12 per cent) could be aggregated in view of the italised words due to the above mentioned underlined words. Provisions of section 4 of the 1956 Act were quite clear as is evident from sub-section (3) which states that in determining whether one company is a subsidiary of another subject to the provisions of clauses (*c*) and (*d*), any shares held or power exercisable (*i*) by any person as a nominee for that other company (except where that other is concerned only in a fiduciary capacity), or (*ii*) by, or by a nominee for, a subsidiary of that other company, not being a subsidiary which is concerned only in a fiduciary capacity, shall be treated as held or exercisable by that other company. It is, therefore, suggested to revert back to the provisions of section 4(3) of the 1956 Act.

Definition of 'holding company'

2. Clause (46) of section 2 defines 'holding company' in relation to one or more other companies to mean a company of which such companies are subsidiary companies.

Anomaly

2.1 In the definition of 'holding company', there is no mention of the phrase "expression 'company' includes any body corporate" making it difficult to identify status of the holding company. For example, ABC Inc., USA holds 70 per cent of the share capital in ABC India (P.) Ltd. In accordance with the Act the status of ABC Inc., USA is body corporate [as it is a company incorporated outside India]. Now, since the definition of 'holding company' does not include the phrase that "expression 'company' includes any body corporate"; the status of ABC Inc., USA cannot be regarded as 'holding company' in spite of holding more than half of the total share capital. It would be prudent to bring clarity in the definition as it is a very basic provision defining the relationship between two companies. There are many references of 'holding company' and 'subsidiary company' in other parts of the Act. In the 1956 Act there was no such anomaly as section 4(5) of the 1956 Act made it clear that the expression 'company' includes any body corporate. To remove this anomaly, there is a need to amend clause (*46*) of section 2 by including the phrase "the expression company includes any body corporate", or to revert back to the provisions of section 4 of the 1956 Act.

The Ministry of Corporate Affairs clarified *vide* General Circular No.23/2014 dated 25th June, 2014 that there is no bar in the Act for a company incorporated outside India to incorporate a subsidiary either as a public company or a private company. An existing company, being a subsidiary of a company incorporated outside India, registered under 1956 Act either as private company or a public company by virtue of section 4(7) of the 1956 Act, will continue as a private company or public company, as the case may be, without any change in the incorporation status of such company.

Conclusion

3. The Ministry of Corporate Affairs needs to take immediate steps to rectify anomaly in the definitions of 'holding company' and 'subsidiary company' because it may have a significant impact on working of corporates in India and also multinational companies in India. After defining the relationship of holding and subsidiary company, there are quite a few other related compliances such as related party transactions, preparation of annual accounts, consolidation of annual accounts, etc., which will have an impact. ❖❖