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Deemed status for indian private limited company of a body corporate

POSITION UNDER THE COMPANIES ACT, 1956

Section 3(1)(iv)(c) mandates that a private company which is a subsidiary of a public company shall be deemed to be a “public company”.

The deemed public companies are viewed by the law as public companies and are subject to more or less all compliances as are applicable on public companies, even though these companies may be operating as private companies.

Then Section 4(7) stated “that 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. This meant two things:

1. The subsidiary would be a public company if the foreign holding body corporate would be a public company, had it been incorporated in India;
2. The subsidiary would continue to remain a private company if the foreign holding body corporate, alone held or in conjunction with other foreign body corporate held the entire share capital of the subsidiary.

Thus, the position of a private company was quite simple and clear. And using this saving grace, most foreign companies have operated in India without having to bear the burden of increased regulatory oversight and compliances that are applicable to public companies.

POSITION UNDER COMPANIES ACT, 2013

Section 2(11)- Body corporate or corporation includes a company incorporated outside India but does not include-

- i. A co-operative society , registered under any law relating to co-operative Societies; and*
- ii. Any other body corporate (not being a company defined in this act), which the central Government may, by notification, specify in this behalf.*

Negative definition of “Body Corporate” is provided by including all the companies incorporated in India and outside India except cooperative society whereas Central Government has not yet issued any notification under this sub-section.

Section 2(71): “Public company” means a company which—

- a) is not a private company;*
- b) has a minimum paid-up share capital of five lakh rupees or such higher paid-up capital, as may be prescribed:*

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.

Section 2(87): “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. exercise 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:*

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 in sub-clause I or sub- clause II is or another subsidiary company of holding company;*
- b) The composition of company’s Board of Directors shall be deemed to controlled by other company if that other company exercise of some powers exercisable by at its discretion can appoint or remove all or majority of directors;*
- c) The expression “Company” includes any body corporate;*
- d) “layer” in relation to holding company means its subsidiary or subsidiaries.*

If we carefully look at the proviso to Section 2(71) and Explanation (c) of Section 2(87), we find that the use of the words “not being a private company” is troublesome. A subsidiary company will be a deemed public company if the holding company is NOT a private company. The holding company can be anything else. It could be a body corporate also. Also Explanation (c) says that the expression ‘Company’ includes body corporate. That means a subsidiary of a body corporate incorporated outside India will surely be treated as a deemed public company. Although it can be argued that the Explanation says “for the purposes of this clause”, it goes without saying that this clause is nothing but the definition of a subsidiary.

Upon reading the proviso to Section 2(71) one more thing comes out to the fore. Even if the subsidiary company, by its articles, choose to remain a private company, it will be treated as a deemed public company for all purposes of the Act. Thus a subsidiary may remain private by its own choice as far as its internal matters are concerned (such as not inviting public to subscribe in shares etc.), but in the eyes of law, it will be public and have to comply with the provisions as are applicable to the Public companies.

Deemed Public Company –

Under Companies Act, 1956

Section 4(7) - A company shall be deemed to be subsidiary of other company, if other company exercise or controls the composition of Board of directors or controls more than 50% of total equity share capital or total voting capital.

Under the companies Act, 2013

Section 2(87) - A subsidiary company, in relation to any other company (that is to say the holding company), means a company in which:

- the holding company controls the composition of the Board of Directors i.e.

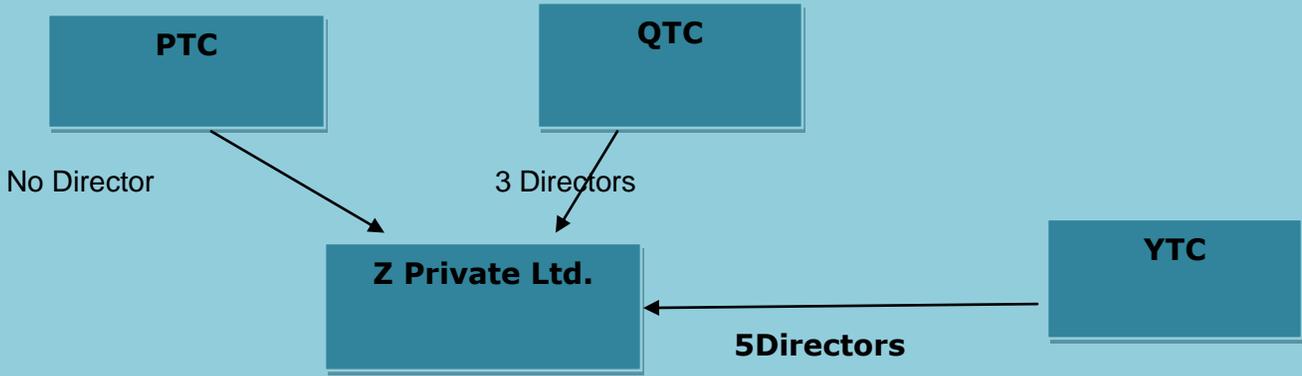
if that other company by exercise of some power exercisable by it at its discretion can appoint or remove all or a majority of the directors; or

- the holding company exercise or control more than half of the “total share capital” either at its own or together with one or more of its subsidiary companies.

The concept of holding - subsidiary company relationship, as far as it relates to exercise or control of more than half share capital is concerned, requires one to consider the investor company’s shareholding in the total paid up share capital of the investee company for which the relationship is to be examined.

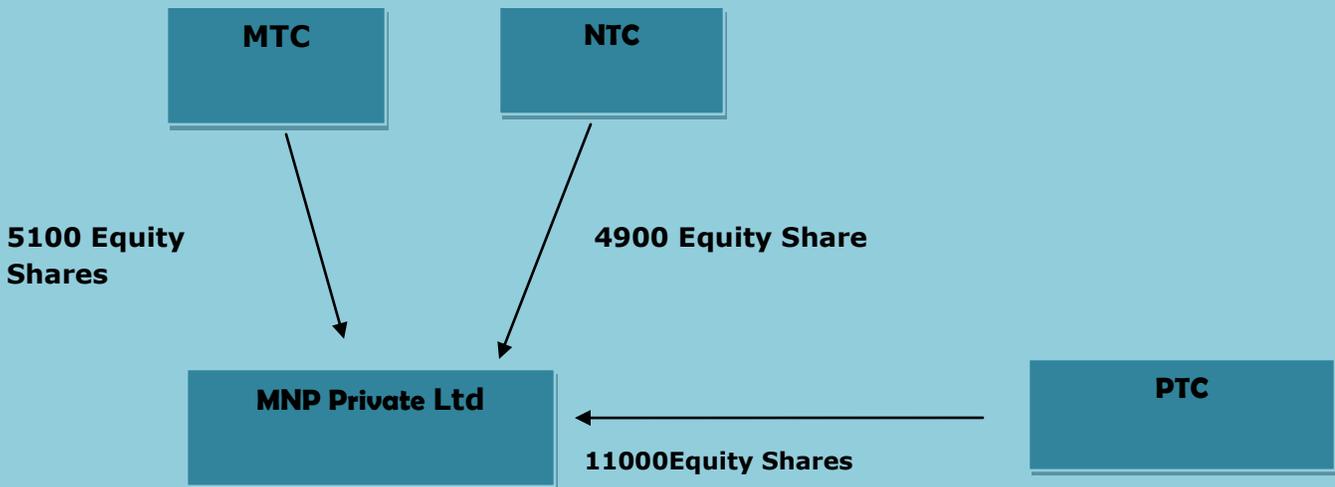
The position is as depicted below:

1. Control – Board of Directors



Example-1: Z Private Ltd. is a subsidiary of YTC but will become Deemed Public Company if YTC is Body Corporate as per Section 2(11) in terms of Explanation c to Section 2(87)

2. Deemed Public Company



Example-2: Equity / Preference shares of INR 10/- each.

In this Scenario, MNP Private Limited will be treated as Deemed Public Company under the Companies Act, 1956 if PTC is Body Corporate as per Section 2(11) and is incorporated outside India.

Contradiction - AS 21 - Consolidated Financial Statements defines a *Subsidiary as an enterprise that is controlled by another enterprise.*

Control is defined as

- a) The ownership, directly or indirectly through subsidiary (ies), of more than one-half of the voting power of an enterprise; and / or
- b) Control of the composition of the board of directors control of the composition of the board of directors in the case of a company or of the composition of the corresponding governing body in case of any other enterprise so as to obtain economic benefits from its activities.

The definition of a “subsidiary company” under the Companies Act, 2013 is also based on the ownership of the total share capital which includes convertible preference share capital. This will have a significant impact on several companies which have issued preference shares. This definition also does not consider the concept of control over voting power covered in AS -21.

Impact on FDI: This will drastically affect a large section of foreign companies because they will now have no choice but to comply the requirements and restrictions of a public company and forego the benefits of being a private company, even if the company chooses to remain private by its articles .In fact, many foreign companies may choose not to open subsidiaries in India.

If foreign companies cannot incorporate themselves as private companies, then much of their enthusiasm will be lost and most of them will be deterred from coming to India. In a country that is in scrambling competition for a share of global fund flows, is facing an enormous current account deficit and is trying to improve its tarnished image to foreign investors, the provisions of the Companies Act, 2013 are only worse than discouraging.

Foreign companies have for long operated in India by opening their subsidiary (ies) in India. These subsidiary companies have enjoyed the status and privileges of a private company. However, with the passage of the Companies Act, 2013 in August 2013, the position of an Indian subsidiary of a foreign company has been thrown into sharp relief and has left the FDI sector in utter shock.

CONCLUSION

The 2013 Act has ushered in a new era of corporate democracy making a titanic shift from “government control” to “self-governance”. It is clarified that the subsidiary of public company (and also of body corporate) shall be deemed to be public company even if such subsidiary company continues to be a private company in its article. The concept of holding – subsidiary company relationship, as far as it relates to exercise or control of more than half share capital is concerned, requires one to consider the investor company’s shareholding in the total paid up share capital (i.e. equity and convertible preference shares) of the investee company for which the relationship is to be examined.