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Navigating the Legal Ambiguity: The Public-Private Status of an Indian Subsidiary of an Overseas Holding Company

SEHAJPREET KAUR[1]

ABSTRACT

The enactment of The Companies Act, 2013 has replaced The Companies Act, 1956. This has led to the evolution of the corporate landscape in India. The 2013 Act has tried to make Indian Company Laws at power with the Global standards, but it has furnished certain ambiguities in the legal framework. One of the areas where these ambiguities have arisen is the status of an Indian subsidiary of the overseas holding company. It has created obfuscated legal framework regarding the classification of private subsidiary to be deemed public or retain its status as private company. This paper seeks to examine the legislative provisions governing this classification with a focus on the background of The Companies Act, 1956, the omission of section 4(7) in The Companies Act, 2013 and clarification provided by the Ministry of Corporate Affairs in 2014. We will explore the implications of the "deeming" provisions that affect the governance and regulatory obligations of these subsidiaries and the holding companies, and further assess its broader legal ramifications.

I. INTRODUCTION

The Companies Act of 1956 encapsulated the definition of a Public Company in section 3(1)(iv)(c), stating *"public company means a company which is a private company which is a subsidiary of a company which is not a private company."*[2] This definition included a private subsidiary company into the realm of a public company, if it was a subsidiary to a Public Company. As per section 4(5), the term "company" for the purposes of this section included a body corporate.[3] The term "body corporate" as per section 2(7) meant any company incorporated outside India.[4] However, the Act provided a crucial exemption under section 4(7) which aided the Private Subsidiary Company to retain its character as private and not be deemed public in certain conditions: firstly, when the Holding Company if incorporated in India was

[1] Author is a student at Jindal Global Law School, India.
[2] The Companies Act, 1956, s 3(1)(iv)(c) (India).
[3] The Companies Act, 1956, s 4(5) (India).
[4] The Companies Act, 1956, s 2(7) (India).

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private and secondly, if the holding company either alone or together with one or more body corporates, held the entire share capital of the Subsidiary Company.[5] Sub section (7) of section (4) served as a saving clause for private subsidiary companies. All these sections read coherently provided clarity as to the status of a Private Subsidiary Company as private or deemed public. They also provided subsidiaries to enjoy the benefits of being classified as private company. But, this sort of clarity is missing in The Companies Act, 2013.

II. The Companies Act 2013

The enactment of the Companies Act, 2013, was an evolutionary moment for Indian corporate law. It aimed to modernize the regulatory framework and enhance transparency in the corporate world. It also brought ideas of good corporate governance and corporate social responsibility into the corporate realm. The have been multiple changes in the 2013 Act. One significant change is the omission of Section 4(7) of the 1956 Act. It had previously provided clarity regarding the classification of status of Indian subsidiaries of foreign holding companies. The 2013 Act introduced a new "deeming" provision under Section 2(71). The proviso to clause 71 of section 2 states: "*A company which is a subsidiary of a company, not being a private company, shall be deemed to be a public company for the purposes of this Act, even where such subsidiary company continues to be a private company in its articles.*"[6] This section tells that a private company which is a subsidiary of a public company would be deemed private, albeit in its articles, it will remain a private company. In *Dcit Central Circle 16 New Delhi, Delhi vs Comptech Solutions Pvt Ltd, New Delhi*[7], it was held Proviso to section 2(71) provides an exception in the definition of "public company". It provides that a private company which is a subsidiary of a company which is not a private company, shall be deemed to be "public company" even though such subsidiary company is a private company in its articles.

In order to understand section 2(71) as a whole, we need to look at the meaning of the word "company". Under clause 87 of section 2, the word company includes body corporate.[8] The term "body corporate" is defined under clause 11 of section 2, which includes companies incorporated outside India.[9] This throws light on the expansive nature of the word company used in this section. This provision is quite broad in scope. The bare text of this provision implies that any company which becomes the subsidiary of a public company would be deemed public. The literal interpretation of this clause therefore also implies that any Indian subsidiary

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[5] The Companies Act, 1956, s 4(7) (India).
[6] The Companies Act, 2013, s 2(71) (India).
[7] Dcit Central Circle 16 New Delhi, Delhi v. Comptech Solutions Pvt Ltd, New Delhi, (2022) ITA 1773 DEL.
[8] The Companies Act, 2013, s 2(87) (India).
[9] The Companies Act, 2013, s 2(11) (India).

of a foreign holding company, that is not a private company would automatically be deemed a public company. Unlike the old section where the saving clause of 4(7) gave opportunity for Private Subsidiaries to retain its private character is not given in this section. This creates intense ambiguities for the status of these subsidiaries.

III. Implications of becoming "deemed public"

The Companies' Act, 2013 does not statutorily define the term "Deemed Public Company". We can find its mention in the clause 71 of section 2 of the 2013 Act. Any company which is subsidiary of a public holding company is referred to as deemed public company. According to this clause, the deemed public company must retain the private status of the company in its articles of association. This implies that the deemed public company needs to comply with the restrictions laid out in clause 68 of section 2. This clause restricts the company, the right to transfer its shares. It also limits the members of the company to be not more than 200 and prohibits invitation to the public to subscribe for any securities of the company.

This has been the judicial stance for both the 2013 Act and even the 1956 Act, where it wasn't explicitly mentioned. For instance, in *Needle Industries (India) Ltd. v. Needle Industries Newey (India) Holding Ltd.* (1981)[10], the Supreme Court held that a private company becoming a deemed public company retains its core characteristics as a private company under its articles of association. The judgment reinforced that, despite this transition, the company must comply with public company governance norms but can still maintain its private company constitution. Similarly, in *Hillcrest Realty Sdn. Bhd. v. Hotel Queen Road (P) Ltd.* (2006)[11], it was held that even though a private company became a deemed public company, it could continue to adhere to the share transfer provisions in its articles. Thus, the company's shares did not automatically become freely transferable after attaining deemed public company status. Court held that restrictions given under 2(68) for private companies have to be mandatorily followed by deemed public company as well if they were originally private companies.

Upon becoming a deemed public company, we understood that the private company has to be private in its constitution i.e. in its articles, but the deeming provisions of being public puts additional obligations on the company which have to be complied with. This creates the hybrid nature, requiring the deemed public company to abide by both private and public company rules. The ministry of corporate affairs notification dated 6 June 2015, had laid out exceptions for private companies.[12] The private subsidiaries which become deemed public because of being a

[10] Needle Industries (India) Ltd. v. Needle Industries Newey (India) Holding Ltd, (1981) AIR 1981 SC 1298.
[11] Hillcrest Realty Sdn. Bhd. v. Hotel Queen Road (P) Ltd., (2006) 71SCL41(CLB).
[12] Ministry of Corporate Affairs (MCA), Notification no GSR No. 466(E), 5-6-2015.

subsidiary to a public holding company can not avail most of these exceptions. Following are some of the obligations imposed on private companies on becoming deemed public:

- *Financial Assistance Restrictions:*

Once a private company becomes a deemed public company, it is subject to the restrictions outlined in Section 67 of the Companies Act. This section otherwise doesn't apply to private companies but if a body corporate has invested in its share capital then this exemption can't be availed. This section prohibits public companies from providing any direct or indirect financial assistance, such as loans, guarantees, or the provision of securities, for the purchase or subscription of its own shares or those of its holding company.[13] This prohibition also applies to deemed public companies. Deemed public companies therefore operate under stricter financial regulations, ensuring that they do not facilitate share acquisition through their own financial resources.

- *Prohibition on Acceptance of Deposits:*

Section 73 imposes restrictions on accepting deposits from the public.[14] A deemed public company must fully comply with the provisions of Section 73, which include: Complying with all conditions related to accepting deposits, including those applicable to public companies and prohibiting the acceptance of deposits from its members without following the detailed procedures outlined in the Act.

- *Governance Flexibility and Articles of Association:*

Private companies have greater flexibility in governing their internal matters through their Articles of Association (AoA). However, once a private company becomes a deemed public company, this flexibility is curtailed. The company must now adhere strictly to the provisions of Sections 101 to 107, which regulate matters such as:

- Notice of meetings (Section 101)
- Statements annexed to the notice (Section 102)
- Quorum for meetings (Section 103)
- Appointment of chairman (Section 104)
- Proxies (Section 105)
- Restrictions on voting rights (Section 106)

[13] The Companies Act, 2013, s 67 (India).
[14] The Companies Act, 2013, s 73(India).

- Voting by show of hands (Section 107)

These sections require public companies, including deemed public companies, to follow more stringent procedures regarding their governance, diminishing the leeway they previously enjoyed as private entities.

- *Appointment of Internal Auditors and Auditors):*

Section 138 of the Companies Act requires public companies to appoint an internal auditor.[15] The appointment criteria for private and public companies differ. Upon becoming a deemed public company, the company must adhere to the rules applicable to public companies which requires every public company with paid-up capital of ₹50 crore or more, turnover of ₹200 crore or more, or loans exceeding ₹100 crore must appoint an internal auditor. For deemed public companies, this means that their financial thresholds and reporting obligations become subject to stricter audit requirements.

Similarly, under Section 139, deemed public companies must follow public company regulations for appointing and rotating auditors.[16] The Act prohibits the appointment or reappointment of an individual auditor for more than one term of five consecutive years and an audit firm for more than two terms of five consecutive years.

- *Appointment of Independent Directors:*

Section 149 mandates the appointment of independent directors for public companies.[17] Specifically, public companies with paid-up share capital of ₹10 crore or more, turnover of ₹100 crore or more, or loans exceeding ₹50 crore must appoint at least two independent directors. However, there is an exception for wholly-owned subsidiaries (WOS).

For deemed public companies, if they are not wholly-owned subsidiaries, they must comply with the requirement to appoint independent directors if they meet the specified financial thresholds.

- *Provisions Related to Directors:*

Sections 160 and 162 of the Companies Act do not apply to private companies but become applicable when a company gains the status of a deemed public company.

Section 160 contains the right of persons other than retiring directors to stand for directorship, which mandates that the candidacy of directors not retiring by rotation must be proposed by a

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[15] The Companies Act, 2013, s 38 (India).
[16] The Companies Act, 2013, s 139 (India).
[17] The Companies Act, 2013, s 149 (India).

member, along with a deposit of ₹1 lakh.[18] If the candidate is elected with more than 25% of the total valid votes, the deposit is refunded.

Section 162, which restricts the appointment of two or more directors by a single resolution, also applies.[19] This provision ensures that each director's appointment is considered independently, thereby enhancing transparency in corporate governance.

- *Formation of Audit and Nomination Committees:*

Sections 177 and 178 require public companies to form Audit Committees and Nomination and Remuneration Committees.[20] For deemed public companies, the compliance thresholds are the same as for other public companies, which includes paid-up share capital of ₹10 crore or more, turnover of ₹100 crore or more, or loans exceeding ₹50 crore.

- *Special Resolution for Certain Actions:*

Section 180 requires public companies to pass a special resolution to sell, lease, or dispose of the company's undertaking, invest funds in trust securities, borrow money in excess of paid-up share capital and free reserves and extend repayment terms to any director.[21]

A deemed public company must comply with these requirements and pass a special resolution to authorize such actions, which adds an additional layer of regulatory oversight to ensure that major financial decisions are made in the best interest of all shareholders.

- *Restrictions on Loans to Directors and Related Parties:*

Section 185 imposes restrictions on loans and guarantees to directors or related parties for both public and private companies. A deemed public company must comply with these provisions, but there is an exemption for wholly-owned subsidiaries, where loans from the holding company are not subject to this restriction.

- *Related Party Transactions:*

Section 188 governs related party transactions (RPTs).[22] While private companies enjoy certain exemptions under this section, deemed public companies must comply with the provisions regarding RPTs, which include obtaining board and shareholder approval for significant transactions. However, transactions between a holding company and its wholly-owned subsidiary are exempt from the requirement of passing a resolution.

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[18] The Companies Act, 2013, s 160 (India).
[19] The Companies Act, 2013, s 162 (India).
[20] The Companies Act, 2013, s 177& 178 (India).
[21] The Companies Act, 2013, s 180 (India).
[22] The Companies Act, 2013, s 188 (India).

- *Appointment of Key Managerial Personnel:*

Section 203 mandates that public companies with paid-up share capital of ₹10 crore or more must appoint key managerial personnel (KMP), such as the CEO, Managing Director, CFO, and Company Secretary.[23] Deemed public companies must comply with this requirement if they meet the financial threshold.

- *Filing of Board Resolutions (E-form MGT-14)*

Under Section 117, public companies must file certain board resolutions with the Registrar of Companies (ROC) through e-form MGT-14.[24] A deemed public company must file resolutions related to the issuance of securities, borrowing, loans, and other significant corporate.

Therefore, the transition from a private to a deemed public company signifies a balance between retaining some flexibility of a being private and some obligation of being public entity. While the company retains certain fundamental characteristics of a private company, such as the restrictions in its Articles of Association, it must adopt a framework of compliance akin to that of public companies. This hybrid status imposes stricter financial and governance oversight.

IV. MINISTRY OF CORPORATE AFFAIRS CLARIFICATION

In 2014, the Ministry of Corporate Affairs (MCA) issued a General Circular (No. 23/2014) to address the confusion arising from the omission of Section 4(7) in the 2013 Act. The circular attempted to clarify the status of subsidiaries of foreign holding companies. It stated that, "*There is no bar in the new 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 the Companies Act, 1956, either as private company or a public company by virtue of section 4(7) of that 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.*"[25] This meant that subsidiary companies would continue to operate as private or public companies without any change in their incorporation status. However, this circular did little to resolve the ambiguity. The language used in the circular failed to acknowledge that the omission of the deeming provision from the 2013 Act would still have legal implications for foreign subsidiaries. The circular reiterated the companies' ability to maintain their private status, but left open the possibility of broader interpretations, particularly regarding compliance obligations. Earlier, as per the 1956 Act, the holding

[23] The Companies Act, 2013, s 203 (India).
[24] The Companies Act, 2013, s 177 (India).
[25] Ministry of Corporate Affairs (MCA), General Circular No. 23/2014, 25/06/2014.

company was required to hold entire share capital of the subsidiary alone or with two or more companies and then only the subsidiary could retain its private character. As per this clarification, any subsidiary of a holding company in which holding company holds more than half of the shares can as well retain its private status. Therefore, this circular sort of tried to clear the obfuscation but further created confusion as to whether conditions of 4(7) need to be fulfilled by subsidiary to retain its private character under the 2013 Act.

V. NAVIGATING FURTHER

This step seems like a strategic move for attracting the overseas companies to establish subsidiaries in India. 4(7) of the 1956 Act, required holding company to hold the shares of the subsidiary in its entirety. Holding shares in entirety allows for more control by the foreign company. So, to act as a saving clause, 4(7) allowed subsidiaries to regulate this control by being private. In corporate law, there is a distinction between subsidiary and wholly owned subsidiary. A subsidiary refers to a company in which the parent company holds more than 50% of the shares, thereby exercising control over its operations. In contrast, a wholly-owned subsidiary is one in which the parent company holds 100% of the subsidiary’s shares, allowing for greater control.

Historically, in the 1956 Act, the companies act provided for more obligations for subsidiaries of public overseas company on attaining status of deemed public company. This had put extra burden on the overseas holding company. However, when the parent company owned the entire shareholding of the subsidiary (i.e., a wholly-owned subsidiary), the law permitted the subsidiary to retain its private company status, allowing it to operate with the flexibility and fewer compliance requirements of a private company. This distinction enabled foreign parent companies to maintain stricter control over their Indian subsidiaries without the burden of being subjected to the full range of obligations imposed on public companies.

Therefore, the omission of 4(7) from 2013 Act, and clarification provided by Ministry of Corporate Affairs doesn’t talk about capital share of subsidiary to be held in its entirety by overseas holding company in order to get away with excess compliance obligations that it otherwise had to bear on their private subsidiary being classified as deemed public. Consequently, overseas holding company can now exercise control and also get away with excess obligations compliance on becoming a holding company for an Indian subsidiary without even holding its entire share capital.

VI. Private vs public subsidiaries: overseas company' preference

Whether a holding company has to invest in public subsidiary or private subsidiary depends on various factors. A key preference for foreign companies if often to establish private subsidiaries. These subsidiaries are subjected to less stringent compliance obligations. Foreign holding companies prefer this lower regulatory burden to avoid the extensive disclosures, auditing, and reporting requirements that public companies face under the Companies Act, 2013. This allows the foreign parent to operate with more flexibility and reduced administrative costs. Further, there is no requirement for issuing shares to the public, which limits external ownership and helps the parent company retain tighter governance over the subsidiary's operations. This ensures that decision-making remains streamlined and aligned with the parent company's strategic objectives.

Contrastingly, Public companies must comply with the stringent regulations of the stock exchanges, including listing requirements, SEBI (Securities and Exchange Board of India) rules, and investor-related obligations. Foreign holding companies may prefer to avoid the volatility and scrutiny associated with public markets and stock exchange regulations. By keeping the Indian subsidiary private, the parent company can avoid public scrutiny. The case of *Sahara India Real Estate Corporation Ltd. v. SEBI (2012)*[26] underscores the importance of compliance for public companies, as the Supreme Court of India highlighted the need for stringent disclosure norms to safeguard investors. This case serves as a reminder of the regulatory complexities that public companies face and how SEBI ensures transparency in public fundraising efforts.

Moreover, the cost of maintaining a private company is significantly lower than that of a public company. Public companies incur additional costs related to initial public offerings (IPOs), annual reports, disclosures, investor relations, and meeting listing standards. Foreign holding companies often prefer to keep their subsidiary's operations private to maintain confidentiality, especially in competitive markets where business strategies, intellectual property, and financial data need protection. Additionally, Private companies have more flexibility in structuring their capital and exiting a private subsidiary is way more easier than public company.

Albeit, there are certain exceptions when foreign companies might prefer having their subsidiaries as public. Public companies provide foreign holding companies with greater liquidity options. This is particularly beneficial if the company is looking to expand operations or invest in large infrastructure projects. A public listing enables the company to raise funds

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[26] Sahara India Real Estate Corporation Ltd. v. SEBI (2012) AIR 2012 SC 3829.

through Initial Public Offerings (IPOs) or Follow-On Public Offerings (FPOs), which private companies cannot access due to restrictions imposed on them.

Public companies can significantly enhance the credibility and reputation of a foreign holding company. This boost in reputation can prove to be fruitful in certain sectors or markets where public perception and trust are crucial. By going public, a subsidiary can tap into the stock market and allow the holding company to diversify ownership. Issuing shares to a broad range of investors not only raises capital but also expands the company's shareholder base. This process creates opportunities for growth and expansion without the parent company having to give up control.

Gladriel Shobe in his article highlighted the advantages of public offerings in broadening the shareholder base. IPOs not only broaden shareholder bases but also allow companies to leverage tax receivable agreements, which are financial benefits specifically arising from the public offering structure.[27] The public companies can attract a larger pool of investors, thereby increasing financial flexibility. Although public companies are subject to stricter compliance obligations and greater transparency requirements, they provide foreign holding companies with substantial benefits. These include access to capital markets, the ability to raise significant funds through public offerings, and an improved market presence. The ability to meet these compliance standards also helps build investor confidence, which can further enhance the company's market position.

VII. Conclusion

The legal status of Indian subsidiaries of foreign holding companies remains fraught with ambiguity because of the the omission of Section 4(7) in the Companies Act, 2013. While a literal interpretation of the Act suggests that subsidiaries of public companies are to be treated as public companies but Ministry of Corporate Affairs' (MCA) clarification circular suggests that these subsidiary companies may retain their private or public character. So there exists no real convergence between 1956 Act, 2013 Act and the MCA clarification of 2014.

The MCA's clarification suggests that a subsidiary's classification, whether private or public, will remain as it was at the time of incorporation This interpretation allows foreign holding companies the flexibility to choose either a public or private subsidiary based on their needs, without the risk of an automatic change in status. Such provisions aligns with India's pro-investment policies, which potentially seek to reduce compliance burdens on foreign

[27] Gladriel Shobe, *Private Benefits in Public Offerings: Tax Receivable Agreements in IPOs*, Vanderbilt Law Review (2018) Vol. 71:3:889.

subsidiaries.

However, this ambiguity also opens the possibility for legal disputes, particularly in situations where the interpretation of the 2013 Act conflicts with previous laws or regulatory expectations. As India continues to attract foreign investment, these issues may prompt calls for further legislative clarification to address the inconsistencies between the 1956 and 2013 Acts. Ultimately, the resolution of this ambiguity will depend on future judicial rulings and potential legislative amendments that clarify the status of these subsidiaries within the framework of Indian corporate law.

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