

Update



MCA's circular imbibes principles of S. 4(3) of Act, 1956 into S. 2(87) of Act, 2013

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Update

The Ministry of Corporate Affairs' circular dated December 27, 2013¹ (“**December Circular**”) reinstates the belief of many – that the provisions of Companies Act, 2013 (“**Act, 2013**”) have been enforced in a haste. The principle contained in section 4(3) of Companies Act, 1957 (“**Act, 1956**”) that was left out while drafting section 2(87) of Act, 2013 has now been imbibed by way of the clarification in December Circular.

Section 2(87) of Act, 2013, which defines *subsidiary* has been enforced since September 12, 2013. The section only lays down two criteria for determination of holding-subsidiary relationship:

1. Control of composition of board
2. Hold more than half of total share capital

Section 4(3) of Act, 1956 clearly laid down that shares held in a fiduciary capacity shall not be counted for the purpose of concluding holding-subsidiary relationship. This is to say, if A is holding shares in C, only in a fiduciary capacity towards B, then C will not be the subsidiary of A. It will however, be the subsidiary of the beneficiary i.e. B. Shares held in fiduciary capacity and exercised by A shall be taken as held and exercised by B.

The word “fiduciary” is usually used to describe the relation that a director has with a company i.e. to do acts and deeds for the benefit of the company. It is also common for an individual to have only legal ownership with the company being the beneficial owner to fulfill the requirements under law, case in point being shareholding in a wholly owned subsidiary company. However, it may be unusual for a company to hold shares in a fiduciary capacity for another company. Usually, banks may hold shares in fiduciary capacity for their nominee clients or FIIs may hold for their sub-accounts. Even portfolio managers may hold shares for their portfolio investor. Companies offering trusteeship services like debenture trustees also fall in the same bracket as companies holding shares in fiduciary capacity (section 4(3)(c) of Act, 1956). Also, shares held only as a security say in case of pledge shall not be counted for determining holding-subsidiary relationship (section 4(3)(d) of Act, 1956).

The elaborate detailing under section 4 of Act, 1956 was lost in the way *subsidiary* has been defined in Act, 2013. The December Circular has clarified what section 4(3)(a) of Act, 1956 already contained for the purpose of counting under section 2(87) of Act, 2013. However, there has been no specific mention of imbibing the provisions of sections 4(3)(c) and 4(3)(d) of Act, 1956. Ideally section 4(3) of Act, 1956 in entirety should have been imbibed rather than initiating one more round of discussion regarding scenarios under sections

¹ Read the entire circular at http://www.mca.gov.in/Ministry/pdf/General_Circular_20_2013.pdf



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4(3)(c) and 4(3)(d) of Act, 1956 and the probable effects that these may have in concluding holding-sub subsidiary relationship now that section 2(87) of Act, 1956 has been enforced.

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1. *Corporate governance disputes: Litigation points to new era of liability of professionals and non-executive directors* at http://india-financing.com/images/Articles/Corporate_governance_disputes_Litigation_points_to_new_era_of_liability_of_professionals_and%20non-executive_directors.pdf
2. Section 185 of Companies Act 2013: Straight answer to some nagging questions at [http://india-financing.com/images/Articles/Section_185_of_Companies_Act_2013_STRAIGHT_A
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