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Newsflash: Restriction on number of layers of subsidiaries for certain classes of holding companies

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1.0 Background

Section 2(87) of the Companies Act, 2013 (Act) defines a subsidiary company as under:

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. 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:

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.

Ministry of Corporate Affairs (MCA) has on 20th September, 2017, notified the commencement of the above proviso.

Vide its notification no. G.S.R. 1176(E) dated 20th September 2017, MCA has also notified 'the Companies (Restriction on number of layers) Rules, 2017' (Rules).

Thus, the Rules and proviso to clause (87) of section 2 of the Act has become operational with effect from 20 September 2017.

2.0 Notification on Restriction on number of layers for certain classes of holding companies

The aforesaid proviso read with the Rules which came into force with effect from 20th September, 2017, restricts all companies other than a company belonging to the exempted class to have more than two layers of subsidiaries. *[The definition of Subsidiary Company under the Act and a web link to the newly notified rules is provided in Annexure A to this newsflash]*

The provisions of this rules are not in derogation of the proviso to sub-section (1) of section 186 of the Act, i.e. whereas sub-section (1) of section 186 of the Act restricts an Indian Company to make investments through more than two layers of **investment companies**, the newly notified rules restricts all companies other than a company belonging to the exempted class to have more than two layers of any kind of subsidiaries. (i.e. **investment as well as operating subsidiaries**)



3.0 Implications-Grandfathering provisions

The restrictions would come into effect only prospectively and thus every company other than a company belonging to the exempted class, existing on or before the commencement of these rules, which has number of layers of subsidiaries in excess of the two layers:

- i) shall file, with the Registrar a return in Form CRL- I disclosing the details specified therein, within a period of one hundred and fifty days from the date of publication of these rules in the official Gazette i.e. **on or before 17th February, 2018**;
- ii) shall not, after the date of commencement of these rules, have any additional layer of subsidiaries over and above the layers existing on such date; and
- iii) shall not, in case one or more layers are reduced by it subsequent to the commencement of these rules, have the number of layers beyond the number of layers it has after such reduction or maximum layers allowed, whichever is more.

However, the provisions of this sub-rule shall not affect a company from acquiring a company incorporated outside India with subsidiaries beyond two layers as per the laws of such country.

Also, for computing the number of layers under this rule, one layer which consists of one or more wholly owned subsidiary or subsidiaries shall not be taken into account.

4.0 Exempted Class of Companies

Following are the classes of Companies which are exempted under Rule 2(2) from the applicability of the aforesaid restrictions.

- a. a banking Company as defined in clause (c) of Section 5 of the Banking Regulation Act' 1949 (10 of 1949);
- b. a non-banking financial company as defined in clause (f) of Section 45-I of the Reserve Bank of India Act, 1934 (2 of 1934) which is registered with the Reserve Bank of India and considered as systematically important non-banking financial company by the Reserve Bank of India;
- c. **[It is pertinent to note that only systematically important non-banking financial companies are exempted from the applicability of these Rules and not all NBFC's]**
- d. an insurance company being a company which carries on the business of insurance in accordance with provisions of the Insurance Act, 1938(4 of 1938) and the Insurance Regulatory Development Authority Act, 1999 (41 of 1999);
- e. a Government company referred to in clause (45) of section 2 of the Act.

5.0 Punishment for contravention

If any company contravenes any provision of these rules, the Company and every officer of the company who is in default shall be punishable with fine which may extend to ten thousand rupees and where the contravention is a continuing one, with a further fine which may extend to one thousand rupees for every day after the first during which such contravention continues.

Annexure A

■ Definition of “Subsidiary Company” under the Act

Section 2(87) of the Act defines a 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) 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:

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. [The recently notified proviso]

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 to in sub-clause (i) or sub-clause (ii) is of **another subsidiary company of the holding company**;

(b) the composition of a company's Board of Directors shall be deemed to be controlled by another company 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;

(c) the expression "company" includes any **body corporate**;

(d) "layer" in relation to a holding company means its subsidiary or subsidiaries;

■ Weblink to the Companies (Restriction on number of layers) Rules, 2017.

You can access the Companies (Restriction on number of layers) Rules, 2017 on:

http://www.mca.gov.in/Ministry/pdf/CompaniesRestrictionOnNumberofLayersRule_22092017.pdf

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This newsflash is general in nature. In this newsflash, we have summarized MCA notification no. G.S.R. 1176(E) dated 20th September 2017. It may be noted that nothing contained in this newsflash should be regarded as our opinion and facts of each case will need to be analyzed to ascertain applicability or otherwise of the said notification and appropriate professional advice should be sought for applicability of legal provisions based on specific facts. We are not responsible for any liability arising from any statements or errors contained in this newsflash.

26 September 2017

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