Law Journals
A Treasure Trove of Legal Knowledge.

Journal of Taxation and Regulatory Framework
Volume 1, Issue 1
(January-June)
www.stmjournals.com

Position of Associate Company: Before and After 2016 Amendment Bill

Srijan Jha*
Student
Dr. Ram Manohar Lohiya National Law University, Lucknow, Uttar Pradesh, India

Abstract

In a nutshell, the objective of this making is to ascertain and look out for a source that can be greatly relied upon when the aspect of determination of an associate company pops up, in the light of legislative intent. As we are discussing this topic, the Lok Sabha has already launched an amendment bill, which seeks to make the definition universal under all business and regulatory laws. This goes on to show that there is an existing lacuna in the law, which the proposed legislation wants to eradicate. Even though this is not a generally taken legal argument, still, the Supreme Court has opined this view and decided in sync with the proposed legislation. This project is aimed at not only understanding that particular lacuna, but also the problems that can come with the same and the contradicting scenarios that may appear because of it, but also about how the new legislation is supposed to work in a different, more effective direction, and analysing how the changes will take their course.

Keywords: *Accounting principle, Amendment bill, Governance, Influence, Proposed legislation, Supreme Court*

****Author for Correspondence*** E-mail: srijan.xavier.nlu@gmail.com

INTRODUCTION

The government has placed a Bill before the Lok Sabha to amend the Companies Act, 2013 (the "2013 Act"), passed around 5 years ago, proposing nearly 100 amendments, purported to be for the ease of doing business. Most of the amendments proposed in the Bill are to implement the recommendations of the Company Law Committee, which was appointed in response to thousands of complaints that the 2013 Act was unduly restrictive and counter-productive.

The major amendments mooted in the Bill are:

- Section 185 of the 2013 Act, one of the most unproductive sections prohibiting loans and guarantees by companies to entities in which directors are interested, will be narrowed down, to permit companies to give loans and provide guarantees based on a shareholders' resolution.
- Universal object companies will be permitted.
- Wholly-owned subsidiaries of foreign companies will be permitted to call their extra ordinary meetings outside India.
- Central government control on managerial remuneration is proposed to be completely omitted. Section 197, which places limits on managerial remuneration, will now require special resolution only if the limits placed under the law are exceeded.
- Position of associate companies.

Section 2(6) of the Companies Act, 2013, has defined associate company for the first time under the head of company governance and company law and not just for auditing as "associate company", in relation to another company, means a company in which that other company has significant influence and includes a joint venture company. *Explanation* – For the purposes of this clause, "significant influence" means control of at least 20% of total share capital, or of business decisions under an agreement.

For the first time, associate company was defined under the statute. Before this, the only authority was that of *accounting standard*. The basic difference between the two is that accounting standards stand only for auditing and accounting whereas if there is a provision in the Companies Act, it would lead to clarity on adjudicating and governance fronts.

The point of understanding in the given definition is that of "significant influence", which either is 20% control of the share capital or control of business decisions under an agreement. Hence, if in case this threshold of 20% is not established, there is a hidden power provided to the court to decide whether some design falls under the head of associate company or not.

The next aspect is of particularly different existence of an associate company from that of a joint venture. Against all odds, the accounting standards consider both to be the same, whereas the judicial decisions give different reasons and arenas to the two. The reason behind the same is that accounting standards are for auditing and making of accounts and hence even if there is no difference between the two there is not going to be any problem, whereas if in case the two are termed to be the same there will be a great gap in corporate governance and the stand of both the companies towards each other.

EXISTENCE OF AN ASSOCIATE COMPANY

Dominated

Significant influence happens to be a true accounting principle, and hence, the aspect of shareholding comes into picture. The quantum of shareholding in the present case is tilted away factually, but a purposive interpretation of the statute would lead us to find that in the case of a public company, a percentage such as 18% is actually a big amount, as even the owners and promoters have a substantive piece of shareholding [1].

Another example of domination and responsibility that is at the discretion of holding company over the associate company is that of disclosure of financial statements of the associate company is always to be done by the holding company [2].

The last analogy to show that every associate company always lives and breathes under the shadow of the holding or parent company would be that there cannot be any financial transaction between a parent company and an associate company [3], prohibition on security purchase of an associate company by the holding company [4], and restriction on mergers and amalgamations between the parent company and the associate company [5]. So, every associate company is not a being of its own as a substantive chunk of responsibilities lies in the hands of the parent company.

The Indian stance on associate company is particularly close to the stance that USA legislations take. Even in USA, the aspect of autonomy of associate company is only on paper, and in reality, every associate company lives and breathes under the nose of the parent company. Even though, it has not been clearly notified in the major company acts, yet slight mentions in other acts show that proper disclosure must be there for related party transaction [6] and balance sheets of associate company must accompany the balance sheet of the parent company at the time of audit [7]. In UK, the concept is replaced completely by that of 'associated company'.

In *Yaddiah v State of A.P.* [8], it was so held that if there is an existing lacuna in law then the rectification must be immediate and to affect the same there can be an action to incorporate that change. The lacuna in the present law is that proving of significant influence as there should be a control in business decisions, which is a very big task, and even the legislature has considered it. If we do an analysis of all the places where the term 'associate company' appears in the statute, we find that firstly the phrase 'holding or subsidiary company' has been replaced by 'holding or subsidiary or associate company'. This clearly indicates the categorization of associate company with subsidiary company, and the nature of subsidiary company is to always act according to the wishes and decisions of the holding company. An example can be Section 2(76) (vii)(A) of Indian Companies Act, 2013, which now even includes associate company as a related party.

So, an amendment bill has been introduced in the Lok Sabha and it reads as *–(i) in clause*

(6), for the Explanation, the following Explanation shall be substituted, namely:
'Explanation. —For the purpose of this clause –
(a) the expression "significant influence" means control of at least twenty per cent of total voting power, or control of or participation in business decisions under an agreement;

Now, even participation under an agreement could construe there being significant influence. This is a clarifying amendment, which clarifies the stand of legislation on this point, and does away with the lacuna in the present case.

A regulation is also a law. "Permanent Settlement Regulation was another law that was enacted by any other Indian Law by a legislative machinery…." [9]. Hence the definition of AS 18 can also come into picture. Definition of significant influence under AS 18 and AS 23 are pretty much on the same lines and they read – *"Significant influence is the power to participate in the financial and or operating policy decisions of the investee but not control over those policies."*

Devoid
In the case of *Godavarman Thirumulkpad vs UOI* [10], it was held that the status of a company being an associate company or not should be derived by looking at its financial statements.

An analysis of associate company in this regard is required. The courts in the country are of the opinion that the so called 'associate companies' [11] are completely devoid of their holding companies. The same was held in the case of *Nisha Seth v GM, HTNL* [12]. Value of assets in the associate company cannot be added to the value of assets in the holding company to provide the holding company with a bigger look [13]. Further, a bid for any action, such as exerting dominance on a third party or coming into an agreement of the parent company and the third party but with the name of associate company cannot be made through an associate company [14]. There is a clear difference between an associate company and a joint venture.

As we have already seen, there are these two extremes under which a company is always construed and hence, a stance which puts the associate company in between is of great requirement.

THE 2016 PROPOSED AMNEDMENT
The relevant section of the Bill reads as –
(i) in clause (6), for the Explanation, the following Explanation shall be substituted, namely:
'Explanation. –For the purpose of this clause–
(a) the expression "significant influence" means control of at least twenty per cent of total voting power, or control of or participation in business decisions under an agreement [15].

The new Companies Act has been in force from 1st April 2014. Many provisions have been extremely hard on the business. The provisions in the Act itself came into picture due to the scams and frauds in some large corporates. A better way to curb such incidents is perhaps a very efficient and clean enforcement process, rather than more legislation.

Corporate India through many industry bodies had reached out to the government to ease some of the provisions. NovoJuris had the privilege of recommending changes and made a representation through NASSCOM and the referendum was filed by NASSCOM a few months ago.

Lok Sabha on 16th March 2016 passed the Companies (Amendment) Bill, 2016, (referred to as "Bill") with 87 modifications. Some of the major highlights of the Bill are as follows:

SPECULATION
Change in explanation of the term 'significant influence' under the definition of *associate company* has been proposed. Significant influence is proposed to mean control of at least 20% of the voting power or control or participation in business decisions under an agreement. Currently the Act provides for control of at least 20% of the "total share capital".

HEAD	PROPOSED AMENDMENT	ANALYSIS
Reservation of Name	At present one could reserve the approved name of the Company for a period of 60 days. In the Bill, the word 60 days is substituted with the word "*20 days from the date of approval"*.	Founders will have to now decide fast and file the incorporation documents within 20 days from the date of name approval. The incorporation process is now by a central office. The centralized system of approval of incorporation has been notified to come into effect from 28 March 2016.
Director Identification Number (DIN)	It has been proposed to recognise any other identification number, as may be prescribed, in place of DIN.	DIN was introduced a few years ago to create a rich and authentic data base of individual directors and to address the phenomena of the companies that raised money from public and subsequently vanished away. If the DIN mechanism is withdrawn, the incorporation process will perhaps be easier (?) But the government will still have to think through the tracking of director's other companies and its compliances.
Affidavit in respect of Subscribers to Memorandum	Submission of declaration on incorporation instead of filing an affidavit.	Currently, an affidavit which requires notarization and a posterization from each of the subscribers to the memorandum and from persons named as the first directors, if any, in the articles that he is not convicted of any offence in connection. The process gets a bit easier by submitting a "declaration".
Intimation regarding change in registered office to Registrar of Companies	The Bill proposes to increase the time-limit to 30 days from the date of change in address of the registered office of the company.	Perhaps a better way of "ease" would have been relaxation of heavy documentation (such as proof such as sale deeds/registration of sale deeds/NOC of landlord)
Change in definition of small company	Definition is proposed to be amended: Paid up capital from earlier Rs. 50 lakhs to now Rs. 10 crores. Turnover: from minimum of Rs. 2 crore and maximum of Rs. 20 crores are now proposed to be revised to a maximum of Rs. 100 crores.	Small companies have benefits of lesser compliances and reporting's. By increasing the limits of paid up capital and the turnover, many more companies will get into the ambit of 'small company' and get benefits.
Omission of having specific Main Object clause	The amendment bill is aiming at omission of incorporating Main Objects in the MoA of the company.	The proposed amendment states that the company may engage in any lawful act or activity or business, or any act or activity or business to pursue any specific objector objects, as per the law for the time being in force. This is in line with international practice.
Definition of Net Worth	Instead of the current definition of securities premium account only, it will now be "Securities premium account and debit or credit balance of profit and loss account".	There is more clarity now.
Definition of **r**elated party	Proposed that "related party" to include (viii) anybody corporate which is – (A) a holding, subsidiary or an associate company of such company; (B) a subsidiary of a holding company to which it is also a subsidiary; Or (C) an investing company or the venture of a company.	With inclusion of "investing company or the venture of a company", implications of venture capital, private equity or institutional investment and the implication of transacting within the portfolio of the investor has to be examined very carefully. Also, the substitution of word 'body corporate' in place of 'company' looks to be also increasing the scope of the definition and may arise in determining the status of a foreign corporate as a related party to a company.
Appointment of auditors	Doing away with the requirements of annual ratification by members with respect to appointment of auditors. Further, under the existing provisions, the auditor who	The proposed amendment reduces the penalty to be paid by auditor if he fails to file the e form ADT-3notexceeding the

	has resigned from the company needs to file Form No. ADT-3 with the company and ROC.	amount of remuneration paid to him.
Deletion of provisions regarding the restrictions on layers of investment companies.	Under the existing provisions a company was not allowed to make investment through not more than two layers of investment companies. The Bill proposes to remove the restriction.	This eases the structuring of group companies and related investments.
Managerial remuneration	Proposed to do away with requirement of obtaining special resolution and approval of central government for payment of managerial remuneration in excess of prescribed limits of Schedule V. Inserts another rigor: Prior approval of bank or public financial institution or non-convertible debenture holder or secured creditor required, before taking approval from shareholders.	The current process of central government permission is a lengthy procedural and time-consuming process. Shareholders' approval is certainly a welcome respite. The added rigor is required to protect the interest of lenders (and other stakeholders)
Issue of shares at discounted price	The Bill allows company to issue shares at a discount to its creditors when its debt is converted into shares in pursuance of any statutory resolution plan or debt restructuring scheme in accordance with any guidelines or directions or regulations specified by the Reserve Bank of India under the Reserve Bank of India	
Issue of sweat equity shares by a newly incorporated company	The bill proposes for deletion of the condition c of section 54 (1)(c) regarding the requirement of completion of at least one year.	With a view to encourage the emerging start-ups and entrepreneurs, the company may now issue sweat equity shares after its incorporation without waiting for one year. However, under the guidelines for ESOP, promoters are still not eligible. We had made a representation that promoters should be eligible for ESOP.
Annual Return	The Bill proposes to remove the extract of annual return forming part of the board's report and providing disclosure of web address/web-link of the annual return in Board's report. It also proposes to omit requirement regarding disclosure of indebtedness, and modify requirement of disclosure of names, addresses, countries of incorporation, registration and percentage of shareholding of foreign Institutional Investors.	This reduces paperwork and makes for easier compliances.
Place of holding the Annual General Meeting	The Bill proposes that Annual general meeting of an unlisted company may be held at any place in India if consent is given in writing or by electronic mode by all the members in advance and such meeting is held. 9 a.m. and 6 p.m. on any day that is not a National Holiday.	The Companies act 1956/2013 allowed companies to hold its general meetings only in the city where the registered office of the company is situated. This proposed change eases the holding AG Many where in India by obtaining 100% approval from members.
Place of holding the **e**xtraordinary general meeting	The extraordinary general meeting of the company, other than of the wholly owned subsidiary of a company incorporated outside India, shall be held at a place within India.	
Authentication of financial statements	The Bill now proposes that CEO who is not a director of the company can sign the financial statements erstwhile only such CEO who was also the director was allowed to sign the financial statements.	Currently, the financial statement shall be approved by the board of directors, before it is signed on behalf of the board by the chairperson of the company or by two directors out of which one shall be managing director, if any.
Number of **d**irectorships	A separate explanation has been inserted in the Bill, stating the directorships in dormant company shall be counted for the purpose of calculate the ceiling limit of number of directorships	So, counting the number of directorships for total directorships is now clarified**.**
Disqualification of **d**irector	The Bill contains a new proviso stating any director who has been disqualified under section 167(2) shall cease to his directorship in other companies except the company in which he has defaulted.	This has a big impact since the director will cease his directorship in all other companies. Perhaps the government feels that this is a bigger deterrent and the director need to

		be more serious of compliances in all the companies in which he is a director.
Meeting through video conferencing or other means	A new proviso has been introduced in the Bill that where there is quorum in a meeting through physical presence of directors, any other director may participate through video conferencing meeting	This will certainly ease the doing of business.
Corporate social responsibility	The Bill provides for composition of the CSR Committee with any two directors, if the company is not bound by the compliances of appointing an independent director.	

The proposed amendment is in congruence with the criteria mentioned in the accounting standards which mention 'voting power' as a criteria to determine significant influence.

Although the term "joint venture" has been used in the definition of "Associate Company" in the Act but meaning of the expression "joint venture" was not explicitly provided in the existing Act. According to the proposed amendment, the expression "joint venture" means a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

The above amendment in the explanation of the 'significant influence' and also the meaning of 'joint venture' is considered to be a welcome amendment as it provides explicit clarity to the stakeholders.

The existing definition had created ambiguity that companies incorporated outside India were excluded from the purview of related party of an Indian company and it was seriously affecting the compliance requirement of related parties under the Act.

Accordingly, the said ambiguity has been cleared off and accordingly pursuant to the proposed amendment, the existing Clause (viii) in the Section is being substituted with a new clause (viii) in terms of which a body corporate (which term under Section 2(11) includes a company incorporated outside India) which is the holding or subsidiary or associate company of such company will also be considered as a related party. In addition, a body corporate which is an Investing company, or the venture of a company would also be a related party.

The substitution of the word 'company' with 'body corporate' would remove any ambiguity or interpretational difficulties that may arise in determining the status of a foreign company as a related party to a company. The effect of this amendment would be to extend the contours of the definition of a related party.

CONCLUSION

Concluding this project, it would be in order to draw the emphasis on pre-2016 stand and the stand that will arise post-2016. Practically, the condition remains the same till the Bill is passed. Even though there used to be mentions of associate company in the accounting standards and the textbooks, associate company still never managed to see the light of the day until the Act of 2013. Pre-2016 amendment Bill, the scenario is that of a novel associate company, and the existence appearing for the first time for proper adjudication and governance. The associate company for the first time had expanded itself from a façade of the target company and come into real life with rights and liabilities.

On the other hand, determination of an associate company still remains to be very difficult, and in the most indirect of senses, in the hands of the judges and officials presiding at the CLBs. But with the advent of 2016 amendment bill, the same shall be negated and we will have the most vivid determination mechanism ever in the legislative history of the world.

The final aspect is of the 'related party' status. An associate company is a related party for sure, and there is no denial for that. But the equation of an associate company with a joint venture is not the healthiest thing for corporate understanding and governance. Accounting standards treat them to be the same; however, in practice these two are different. A joint venture is a mutual establishment of two corporates for a new line of business that they are going to take, whereas an associate company can be a company totally different from the target company or an establishment of the parent company only, in which there is monetary and management guidance coming from the parent company.

REFERENCES

1. Hindustan Lever Employees Ltd v Hindustan Lever Ltd. 1994; SCC online Bom 165.
2. Section 129's Explanation, Indian Companies Act, 2013.
3. Section 188 (1) (f), Indian Companies Act, 2013.
4. Section 194 (2), Indian Companies Act, 2013.
5. Section 233 (10), Indian Companies Act, 2013.
6. Investment Advisor's Act.
7. Trust Indenture Act, 1939.
8. Andhra Law Times. 233 FB.
9. Hullas Narain Singh v Province of Bihar.1942; SCC online FC 1.
10. 2008; 2: SCC 222.
11. UOI v Hindi Lamp.1989l Supp (2): SCC 332.
12. 2001; SCC online Bom: 1091.
13. G.L. Sultania v SEBI. 2007; 5: SCC 133.
14. APM Terminal BV v UOI.2011; 6: SCC 756.
15. Section 2 of Companies Amendment Bill, 2016.

Cite this Article
Srijan Jha. Position of Associate Company: Before and After 2016 Amendment Bill. *Journal of Taxation and Regulatory Framework*. 2018; 1(1): 10–16p.

