REGULATORY GAPS IN PROTECTING SUBSIDIARY AUTONOMY IN SHARE-SWAP ACQUISITIONS IN INDIA

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The paper explores the challenges to the autonomy of subsidiary companies in share-swap based acquisitions in India, that utilize its shares for acquiring shares of a target company. The legal principles deem that subsidiaries are independent of their holding companies; however, there have been various instances that reveal the influence of holding companies in the operations of the subsidiaries due to their significant voting power in the organization and/or control over board. The paper adopts a doctrinal analysis and analyses the recent regulatory relaxations in the corporate jurisprudence under the Foreign Exchange Management ("FEMA") (Non-debt Instruments) Rules 2024, bringing the potential to disregard the interests of the subsidiaries as it boosts share-swap transactions for acquisitions. The regulations provide mechanisms that can unilaterally alter the control in the subsidiary at the sole discretion of the holding company without the involvement of the subsidiary.

The paper addresses the challenges that the holding companies face when using subsidiary shares for acquisitions that can unilaterally alter control and undermine subsidiary autonomy. The recent relaxations in the legislation increase this risk. . It underscores the potential misuse of regulatory relaxations in undermining the subsidiary's autonomy due to the inadequacy of existing governance structures to mitigate the risks efficiently. It explores the practical and theoretical dimensions of subsidiary autonomy erosion under the present regulations. It concludes that the current regulatory framework and the recent relaxations

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do not adequately protect subsidiary autonomy and allow unilateral control changes, and lead to valuation abuse. The paper therefore argues for targeted reforms, including strengthened board-level protections, restoration of related-party safeguards in private companies, and mandatory stakeholder participation when subsidiary shares are used as acquisition currency.

Keywords: *Subsidiary Autonomy, Share-Swap Transactions, Corporate Governance, Holding Company Control, Related Party Transactions, Arm's Length Transaction, Valuation of Shares, Layering of Subsidiaries.*

I. INTRODUCTION

With the passage of time, subsidiary and holding relationships between companies in India have begun to surge. The ability to protect assets during bankruptcy, among various other advantages, has led to companies organizing themselves in this form. The intent of this framework is based on the rationale of providing autonomy to the subsidiaries.[1] However, various challenges have begun to emerge from this relationship in the corporate jurisprudence. The domination of the holding companies in the operations of the subsidiary has been a recurring trend that is pragmatic due to the regulatory framework that governs such relations. It ultimately leads to the juncture where autonomy of subsidiaries is merely a principle on paper, while the holding company exercises control in practice in various organizations. The instances of the courts intervening to lift the corporate veil to hold the holding company liable for the subsidiary's actions serve as a testament to the rampant challenge of autonomy the subsidiaries encounter.[2]

The corporate regulatory regime in India has proved to be lacking and there has been a trend for subsidiary companies being used as a hub to protect solely the interests of the holding

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[1] Bharat Vasani Tripathi Saloni Shroff, Geetika Myer, Harshvardhan, 'Steering the Ship: Accomplishing Board Autonomy Post-Listing' (India Corporate Law, 9 July 2025) <https://corporate.cyrilamarchandblogs.com/2025/07/steering-the-ship-accomplishing-board-autonomy-post-listing/> Accessed 13 July 2025.

[2] Bharat Vasani 'When Is a Holding Company Liable for the Acts and Omissions of Its Subsidiary? A Jurisprudential Analysis | India Corporate Law' <https://corporate.cyrilamarchandblogs.com/2024/03/when-is-a-holding-company-liable-for-the-acts-and-omissions-of-its-subsidiary-a-jurisprudential-analysis/> Accessed 13 July 2025.

company. The paper aims to demonstrate the challenges and the blatant disregard of autonomy of subsidiaries in the scenario where the shares of the subsidiary are utilized by the holding company in acquiring a target company.

In principle, there are two mechanisms that may be opted by the company. First, the shares are treated as an asset of the holding company and the target company issues shares against it under the principle of 'issuance of share for consideration other than cash.' Second, a share swap agreement between the target company and the subsidiary as the holding company in the subsidiary company dominates the control. The paper will delve into both these routes and highlight the challenges of the subsidiaries towards controlling the organization and the lack of safeguards to prevent dilution of control that potentially disregards its operations.

II. Holding and Subsidiary Companies and it's Advantages

A holding company controls one or more subsidiary companies.[3] Subsidiary companies refer to companies that are controlled by a holding company either through ownership of half or more voting power or through the control in determining the composition of its board of directors according to the Companies Act.[4] Under the Companies (Restriction on number of layers) Rules, 2017 holding companies cannot hold more than two layers of subsidiaries to prevent illegal flow of funds or round tripping of money.[5] However, these rules are subject to certain exemptions such as the inapplicability towards banking companies and acquisition exemptions towards a foreign company with existing subsidies of more than two layers, and wholly owned subsidiaries which are usually not counted while analysing this structure.[6]

There exist pre-dominantly four types of holdings in governing such relationships in corporate history.[7] Pure holdings do not participate in business and are solely utilized for the ownership of other companies. A Mixed holding operates a business while managing its subsidiaries. Immediate holdings hold various subsidiaries while it is owned by another entity. An Immediate subsidiary similar to an intermediate company and is owned by a parent company.[8]

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[3] The Companies Act, 2013 (18 of 2013) s 2(46).
[4] The Companies Act, 2013 (18 of 2013) s 2 (87).
[5] The Companies (Restriction on Number of Layers) Rules 2017, Rule 2.
[6] The Companies (Restriction on Number of Layers) Rules 2017, Rule 2.
[7] William O. Douglas and Carrol M. Shanks, 'Insulation from Liability Through Subsidiary Corporations' (1929) The Yale Law Journal 39, 193.
[8] *Ibid*.

These holdings come with ease of formation and can provide various strategic advantages. The primary intention behind holding relationships is protection from liabilities.[9] Creditors are not entitled to the assets of the holding or the subsidiary if the other goes bankrupt. Companies also benefit by diversification of risk and are often utilized for gaining geographical advantages in terms of markets and regulations. Discounted capital may be acquired and transactions can take place that can be priced below the market price.[10] It leads to reduction in transparency regarding the operations of the organization at various instances.[11]

III. Shares of Subsidiary Company Utilized for Purchase of Shares of a Company Under Issue of Shares Other Than Cash Consideration

The utilization of shares of a subsidiary for acquiring a target company would be governed under issue of shares for consideration other than cash under the Companies Act.[12] The provision mandates two requirements for such transaction that include the passing of a special resolution and valuation of such shares based on valuation report by a 'registered valuer.'[13] The company has to provide a justification along with the valuation report of the registered valuer in the explanatory statement that has to be annexed to the notice for the general meeting.[14] The IVSC defines valuation as the process of determining the 'Economic Worth' of an Asset or Company under certain assumptions and limiting conditions and subject to the data available on the valuation date.[15] The Company may issue shares at a premium when issuing of shares for a consideration other than cash however, a sum of equivalent amount of the premium must be transferred to the securities premium reserve.[16]

[9] A. Ramaiya, *Guide to the Companies Act* (19th edn, Lexis Nexis, 2020, Vol. 1) p 430.
[10] Ayşegül Özsomer and Esra Gençtürk, 'A Resource-Based Model of Market Learning in the Subsidiary: The Capabilities of Exploration and Exploitation' (2003) Journal of International Marketing 11, 1.
[11] Julian Birkinshaw, Neil Hood & Stefan Jonsson, 'Building Firm-Specific Advantages in Multinational Corporations: The Role of Subsidiary Initiative' (1998) Strategic Management Journal 19, 221.
[12] The Companies Act, 2013 (18 of 2013) s 62(1)(c).
[13] The Companies Act, 2013 (18 of 2013) s 62(1)(c).
[14] The Companies Act, 2013 (18 of 2013) s 102.
[15] Standards glossary, International Valuation Standards Council, <https://www.ivsc.org/standards-glossary/> accessed Oct 30, 2024.
[16] *Head (Henry) & Co. Ltd. v Ropner Holdings Ltd*. (1951) 2 All ER 994.

3.1. Compliances to sell assets of a company and the unilateral alteration of control of the subsidiary by the holding company

The Companies Act mandates the holding company to publish consolidated financial statements of itself and its subsidiaries. [17] Indian Accounting Standard 110 provides the prescribed manner for the publication of such consolidated statements.[18] Indian Accounting Standard 112 enlists the disclosures related to subsidiaries in consolidated statements. [19] Complying with the regulations, we determine the disclosure of shares held by the holding company of the subsidiary under the equity heading in balance sheet of such consolidated statements.[20] Hence, the holdings of the subsidiary are to be treated as an asset.[21]

To sell the shares of a subsidiary, the holding company is required to pass a special resolution.[22] Following the resolution, such shares could be utilized for acquiring shares in the target company. Hence, the control of the subsidiary can get unilaterally altered by the holding company with a blatant disregard of the board of the subsidiary as well as its minority shareholders rights (if they exist). In principle, the subsidiary companies are to be treated to have its separate legal existence according to the Supreme Court while regulations permit the control of such subsidiaries to be altered unilaterally without its involvement.[23]

It is pertinent to note that the provision related to special resolutions is exempted for private companies vide a 2015 Ministry of Corporate Affairs notification.[24] Hence, these transactions can be undertaken by the Board of private companies without a special resolution. A recent study determined that almost 93% of the registered companies in India under the Companies Act are private limited companies.[25] Potentially, the shares of the subsidiary company can be utilized for acquiring shares of a target company at the sole discretion of the board of the holding company in private companies. The control and management of the subsidiary can be

[17] The Companies Act, 2013 (18 of 2013) s 129 (3).
[18] Indian Accounting Standard 110: Consolidated Financial Statements.
[19] Indian Accounting Standard 112: Disclosure of Interests in Other Entities.
[20] Indian Accounting Standard 110: Consolidated Financial Statements.
[21] Lars G. Gustafsson, 'Holding Company's Stock in a Subsidiary: A Capital or Ordinary Asset' (April 1987) TEX. L. REV. 65, 1029.
[22] The Companies Act, 2013 (18 of 2013) s 180., ICSI, Study Material on Company Law, Executive Program Module 1 paper 2, 2023.
[23] See: *Vodafone International Holdings BV v. Union of India* (2012) 6 SCC 613.
[24] Exemptions to Private Companies under section 462 of Companies Act, 2015, Ministry of Corporate Affairs, G.S.R 464(E).
[25] India: number of registered private companies by sector 2022, Statista, <https://www.statista.com/statistics/1248272/india-number-of-registered-private-companies-by-sector/> accessed Oct 30, 2024.

unilaterally be altered without its involvement, that undermines its autonomy along with the interests of the various other stakeholders that may be shareholders in both the companies.

3.2. Valuation of shares and compliances

There often arises a challenge regarding the valuation of unlisted shares for such transactions as multiple mechanisms and formulae exist. While every regulation mandates the valuation by a registered valuer, there exist various methods to obtain such valuation. Further, as nature and operations of companies are diverse, there cannot exist a straight-jacket formula for such transactions.

There exist various internationally accepted pricing methodologies for the valuation of shares. The Reserve Bank of India as per its circular, recognizes any of these mechanisms for the valuation for the pricing of shares. There exist predominantly three approaches to valuation.[26] These approaches are Asset Based Approach, Earning Based Approach and Market Based Approach. Furthermore, various factors such as control premium, minority discounts and judicial pronouncements are to be considered during the valuation exercise. The Asset Based Approach consists of the Net Asset Value (NAV) Method and the Price to Book (P/B) Multiple Method. The Earning Based Approach consists of the Price Earnings Capitalization Value (PECV) Method, the Enterprise Value (EV)/ EBITDA Multiple (CCM) Method and the Discounted Cash Flow (DCF) Method. The Market Based approach consists of the Market Price Method.[27]

In the Indian taxation regime, Rule 11UA of the Income Tax Rules provides a robust formula in calculation of valuation. The Rule also provides certain discretion to the assessee in such valuation exercises.[28] This discretion has been upheld and justified by various Income Tax tribunals in India. For instance, the Income Tax Appellate Tribunal (ITAT) Mumbai bench held that the Assessee is entitled to discretion to opt for any method of valuation under Rule 11UA and the Assessing Officer (AO) cannot insist to opt for a different method of valuation.[29] The Delhi bench of the Income Tax Appellate Tribunal (ITAT) held the increase in valuation of share prices by the discretion of the assessee was justified in the issuance of subsequent shares

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[26] Master Circular on Foreign Investment in India, Reserve Bank of India, 2014, RBI/2014-15/6, Master Circular No. 15/2014-15.
[27] Institute of Chartered Accountants of India, Technical Guide on Share Valuation (Reprint August, 2012).
[28] The Income Tax Rules 1962, Rule 11UA.
[29] *DCIT v Ozoneland* TS-6963-ITAT-2018(MUMBAI)-O.

by the company and deleted Section 56(2)(vii)(b) of the Income Tax Act.[30] Hence, this discretion provides room for potential challenges in verifying the accuracy of valuation of such transactions. The Foreign Exchange Management Act (FEMA) Rules offer various methods of calculation for the valuation of shares for pricing in international transactions that are internationally recognized.[31] It prescribes specific evaluators with SEBI, while also allowing registered Investment Bankers outside India.[32] This blanket allowance for international valuators as well as the adopting of 'any' valuation method that is internationally recognized further expands the scope of misrepresentation of valuation of shares in such transactions.

It is pertinent to note that the layering rules does not allow acquisitions of companies that have more than two layers of subsidiaries.[33] This regulation has confronted various challenges in the past. The discourse on the subject began with the formation of the Joint Parliamentary Committee headed by Mr. Prakash Tripathi. The report opined that to prevent stock market scams, the misuse of shell companies must be curbed by opting for stricter control mechanisms to control the layering of subsidiaries and incorporation of such shell companies.[34] SEBI also proposed similar provisions and aimed at increasing disclosures. However, a divergence in opinion was undertaken by the Expert Committee on Company law the next year. It opined that restrictions on layering must be discouraged to encourage corporate organizations to work on their corporate framework. Rather, an increase in disclosure requirements must be undertaken to avoid scams.[35] The Companies Act however, retained the position of the Parliamentary committee restricting the layering of companies.[36] Post the implementation of the law, the Companies Law Committee (CLC) Report of 2016 recommended to omit such layering restrictions to aid ease of business. It advocated for aligning disclosures with the clauses of the Money Laundering Act and opting a mechanism to enlist the elements of 'beneficial interest'.[37] However, the Ministry of Corporate Affairs through its notification enacted the Companies (Restriction on Number of Layers) Rules in 2017 to aid the interpretation of Company Law

[30] *Convergys Customer Management Group Inc. C/o. Price Waterhouse Coopers Pvt. Ltd. v DCIT* TS-3-ITAT-2020 (DELHI).
[31] The Income Tax (Twenty-First Amendment) Rules 2023.
[32] Reserve Bank of India, Master Circular on Direct Investment by Residents in Joint Venture (JV) / Wholly Owned Subsidiary (WOS) Abroad, Master Circular No.05/2010-11, 1 July 2020; Reserve Bank of India, Master Circular on Foreign Investment in India, Master Circular No. 15/2011-12, 1 July 2011.
[33] The Companies (Restriction on Number of Layers) Rules 2017, r 2.
[34] Parliamentary Committee Reports, JPC Report on Stock Market Scam and Matters Relating Thereto 19 December 2002.
[35] Ministry of Corporate Affairs, Report of the Expert Committee on Company Law 2005.
[36] The Companies Act, 2013 (18 of 2013) s 2(87).
[37] Ministry of Corporate Affairs, Report of The Companies Law Committee February 2016.

and retained its 2013 position.[38] While the history and the position of the State may be opposing at various stages in the corporate jurisprudence, the legal position continues to restrict layering to prevent pre-dominantly the illegal flow of funds.

Hence, these Layering Rules can be bypassed through these transactions by acquiring equity in foreign companies with multiple layers of subsidiaries. This regulation can serve as a potential haven for illegal flow of funds in holding relationships and serve as a source of audit scams as money can be routed through various layers of the organization in a cyclic manner. Therefore, these transactions can undermine the intent of the Indian regulations.

The transfer being undertaken by the holding company deems the appointment of the registered valuer to be at the sole discretion of the holding as the party conducting the transaction has the onus to carry out the valuation exercise. In the present case, the subsidiary can potentially be excluded from such transactions. Under such circumstances, the valuation of the shares can be portrayed at an inflated or a deflated value by adopting of a formula and the discretion of the valuer that may differ from the valuation adopted by the subsidiary in its regular course of business.

IV. Regulatory Evolution of Share-Swap Transactions and Expansion of Their Scope

A share swap agreement refers to a transaction where the target company is acquired by utilizing the shares of the acquiring company as consideration in the transaction.[39] These transactions have become frequent in modern-day as these allow companies to effectively make strategic investments. Furthermore, the Ministry of Corporate Affairs and SEBI relaxed regulations in 2024 related to share swapping that would encourage such transactions in the sub-continent.[40]

A historical account of the regulations related to share swap transactions provide evidence of relaxations of the compliances for such transactions over the due course of time.[41] Before 2015, share swap transactions were permitted only with Government approval under Rule 3C of the

[38] The Companies (Restriction on Number of Layers) Rules 2017, r 2.
[39] The Foreign Exchange Management (Non-debt Instruments) (Fourth Amendment) Rules 2024, r 4.
[40] See: The Foreign Exchange Management (Overseas Investment) Rules 2022., The Foreign Exchange Management (Overseas Investment) Directions 2022.
[41] Jan, 'Cross-Border Share Swaps Home and Free' (*Law.asia*, 14 November 2024) <https://law.asia/ndi-rules-2024/> accessed 29 December 2024.

Foreign Exchange Management Regulations 2000.[42] Post 2015, the RBI through its notification and Press Note 12 of 2015 by the Central Government relaxed the regulations to provide an automatic route for certain share swap transactions.[43] This position of post 2015 was incorporated in the Foreign Exchange Management Regulations of 2017 under the First Schedule.[44]

The 2019 FEMA Non-Debt Instruments (NDI) limited the scope of share swap transactions only against a swap of equity instruments of another Indian company under Rule 9.[45] However, with the amendment to the Overseas Investment (OI) Rules, now companies can acquire shares of foreign companies in such transactions. Moreover, the FEMA Rules were recently amended in August 2024 to allow Indian companies issue shares in exchange for equity of a foreign company.[46] Rule 9A of the Foreign Exchange Management (Non-debt Instruments) Rules 2024 rules allows share swap transactions with foreign entities that deal with equity instruments.[47] It clarifies that these transactions need to comply with the Rules made by the State over the period of time.[48] The current RBI regulations demand solely the details of the transactions and valuation being done according to the requisite standards. It has to additionally obtain undertakings for future transactions of share-swap.[49]

Furthermore, the SEBI ICDR Rules clarified that transactions that involve issue of preferential shares for consideration other can cash, only share swaps would be eligible for such transactions.[50] Additionally, the Share Capital Rules provide the requirement of a justification and valuation report by a registered valuer in the issuance of preferential shares for consideration other than cash.[51]

[42] Foreign Exchange Management Regulations (FEMA) (Transfer or Issue of Security by a Person Resident Outside India) Regulations 2000, r 3(c).
[43] Reserve Bank of India, Review of sectoral caps and simplification of Foreign Direct Investment (FDI) Policy, 20 October 2016 RBI/2016-17/88, A.P. (DIR Series) Circular No. 6.
[44] Schedule I, Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2017.
[45] The Foreign Exchange Management (Non-debt Instruments) (Fourth Amendment) Rules, 2024, r 9A.
[46] The Foreign Exchange Management (Overseas Investment) Rules 2022; The Foreign Exchange Management (Overseas Investment) Directions 2022.
[47] The Foreign Exchange Management (Non-debt Instruments) (Fourth Amendment) Rules, 2024 Rule 9A.
[48] The Foreign Exchange Management (Non-debt Instruments) (Fourth Amendment) Rules, 2024 Rule 9A.
[49] Reserve Bank of India, Investment by way of share swap, Master Circular on Direct Investment by Residents in Joint Venture (JV) / Wholly Owned Subsidiary (WOS) Abroad, RBI/2010-11/ 5, Master Circular No.05/2010-11, 1 July 2010.
[50] The Companies Act, 2013 (18 of 2013) s 163 (3)., The Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations 2018, r 169.
[51]The Companies (Share Capital and Debentures) Rules 2014, r 13(2)(xii).

Hence, the relaxations of share swap regulations over the past decade hints at the intention of the Sate to promote such transactions. The recent regulations further open the scope for foreign organizations to acquire shares in the Indian market through swaps. While these transactions are being incentivized, they also possess a potential to undermine the autonomy of subsidiary companies as well as financial scams. This will be explored in the next section.

4.1. The Domination of Holding companies in the board and voting power

In India, we often see a trend in holding-subsidiary relationships where employees of the holding company are put on board of the subsidiary. While the subsidiaries are taking the decision of such transactions, it is impossible to get the approval without the holding company's permission as they control more than half the voting power and the transaction requires a special resolution to be passed. Conversely, the holding company may strong-arm the share swap as it dominates the voting in the subsidiary. On one hand, the Supreme Court dictates the autonomy of subsidiaries while there exists a lack institutional safeguards in its governance.

The Companies Act defines control to be related to power to appoint directors and managing operations of the organization.[52] A research study conducted by Deloitte found that 65% of the global companies that were included in the survey had common directors for both holding and subsidiary companies.[53] At the same time, it was also found that 81% of the holding companies extend their policies towards its subsidiaries.[54]

There exists a concept of appointing a minority shareholders director under the Companies Act however, the clause is only applicable to listed companies.[55] Hence, the majority of the registered companies under the Companies Act cannot avail this protection as they are predominantly private limited companies.

The lack of framework can further be highlighted through a series of cases where the Courts lifted the corporate veil to hold the holding company liable for actions of the subsidiary since it enjoyed day-to-day control of affairs of the subsidiary.[56]

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[52] The Companies Act, 2013 (18 of 2013) s 2(27).

[53] Governance of Subsidiaries: A survey of global companies, Deloitte <https://www2.deloitte.com/content/dam/Deloitte/in/Documents/risk/Corporate%20Governance/in-gc-governance-of-subsidiaries-a-survey-of-global-companies-noexp.pdf> accessed 30 October 2024.

[55] The Companies Act, 2013 (18 of 2013) s 151.

[56] Rohin Pujari, 'India - When Is A Holding Company Liable For The Acts And Omissions Of Its Subsidiary? A Jurisprudential Analysis' (*Conventus Law*, 19 March 2024), <https://conventuslaw.com/report/india-when-is-a-holding-company-liable-for-the-acts-and-omissions-of-its-subsidiary-a-jurisprudential-analysis/> accessed 31 October 2024.

The case of LIC Escorts was the first case in the corporate jurisprudence in India to introduce the concept of piercing of the corporate veil by the Supreme Court.[57] The Foreign Exchange Regulation Act of 1973 allowed investment by non-resident individuals in Indian companies up to a five per cent of its paid-up share capital.[58] In LIC Escorts case, the portfolio of the investor controlled thirteen companies which were utilized individually to acquire a stake. The Court held the subsidiary and holdings are inextricably connected as they appear to be a single entity, the corporate veils need to be lifted to understand the intent and impact of the transactions.[59] Since the beneficiaries of the thirteen companies was the same individual, the Court pierced the corporate veil to declare the transaction unlawful.[60]

The case of Hindalco affirms the position about the domination of control by the holding companies in the day-to-day actions of the subsidiary. Hindalco had established the Renusagar Power Corporation to supply electricity to its organization. Renusagar had its own articles distinct from Hindalco however all of its shares were subscribed by the shareholders of Hindalco. The State of Uttar Pradesh raised a claim of duty on the powerplant under the Electrical Duty Act.[61] The company tried to claim that the service was exempted from tax as it was a separate entity. The Supreme Court pierced the corporate veil and held both of the companies to be part of the same entity. The rationale behind the decision was that Hindalco completely controlled its subsidiary Renusagar hence, the subsidiary did not have any independent volition.[62]

The Supreme Court in its landmark Vodafone International Holdings judgment opined that while the holding company exercises control over the shareholders of the subsidiary, the directors of the subsidiaries should act in the interest of the subsidiary rather than a puppet of the holding.[63] Hutchison Telecommunication International Limited (HTIL) transferred shares of its holding company to Vodafone International Holdings. The subsidiary was located at Cayman Islands and Vodafone acquired a sixty-seven percent interest in Essar Limited which was a Joint Venture Company located in India due to the transaction. The Indian revenue authorities claimed Vodafone to be in default of Capital Gain Tax of 12000 Cr. The Supreme

[57] *LIC v Escorts Ltd* AIR 1986 SC 1370.
[58] The Foreign Exchange Regulation Act 1973 (43 of 1973).
[59] *LIC v Escorts Ltd* AIR 1986 SC 1370.
[60] *LIC v Escorts Ltd* AIR 1986 SC 1370.
[61] The UP Electrical (Duty) Act, 1952 (33 of 1952), s 3(4).
[62] *State of U.P. v Renusagar Power Co*. (1988) 4 SCC 59.
[63] *Vodafone International Holdings BV v Union of India* (2012) 6 SCC 613.

Court ruled that the actions of the holding company are separate from the subsidiary and it cannot be made liable for the transactions of the holding company.[64]

The dichotomy that arises from this judgment is that the Court deems subsidiaries to have a separate legal existence, while from the facts of the case, it is evident that there is a unilateral alteration of control in the subsidiary by the holding company from HTIL at a different level. This seems to suggest that this so called separate legal existence is that of a partial nature where the holding company has substantial power to unilaterally drive major changes to the corporate framework of the subsidiary while the subsidiary has to be recognized as a separate entity inherently different from its holding company. In share-swap transactions the board cannot exercise its autonomy and prevent such acquisitions as there does not exist statutory safeguard for the subsidiary.

In the international jurisprudence of corporates, similar challenges in protecting the autonomy of the subsidiary have been highlighted. The Supreme Court of United Kingdom noted that the holding company's ownership of majority of shares in the subsidiary provides scope for its de-facto control over its operations.[65] The Court of Justice of the EU opined that the holding company can exercise direct control and have decisive influence over the conduct of the companies.[66]

4.2. Related Party Transactions between the holding and subsidiary

Related Party Transactions are governed by Section 188 of the Companies Act.[67] It streamlines the legal position into a single provision by amalgamation of Sections 294, 294A, 294AA, 297 and 314 of the 1956 Act.[68] This provision introduces the element of self-governance towards regulating such transactions by providing the discretion to the Board of Directors and shareholders of the company.[69] It includes several parties that may have a direct or an indirect stake at the company and includes (but not limited to) relatives of the directors and key managerial personnel, companies and its subsidiaries along with companies where the director has a stake etc.[70]

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[64] *Vodafone International Holdings BV v Union of India* (2012) 6 SCC 613.
[65] *Vedanta Resources Plc and Konkola Copper Mines Plc v Lungowe and Others* [2019] UKSC 20.
[66] *The Goldman Sachs Groups Inc. v European Commission* Case C-595/18 P.
[67] The Companies Act 2013 (18 of 2013) s 188.
[68] The Companies Act 1956, §§294, 294A, 294AA, 297 and 314.
[69] A. Ramaiya, Guide to the Companies Act (Lexis Nexis, 19th edn., 2020, Vol. 2) 1375.
[70] The Companies Act, 2013 (18 of 2013) s 2(76).

These transactions require the approval of the board of directors.[71] This agreement has to be mandatorily incorporated in the Board's report to the shareholders supported with the rationale.[72] A resolution will be required for agreements that exceed the company's paid up share capital as well as any other monetary limit that may be prescribed.[73]

The proviso of Section 188 provides an exception to treatment of transactions as related party transactions when such transactions are in the regular course of business as well as when the transaction is at 'arm's length'.[74] An 'arm's length transaction' refers to a transaction that is conducted between two related parties without any conflict of interest and the transaction is conducted as if they are unrelated.[75]

The definition of 'arm's length transaction' does not provide a scope towards defining what amounts to a conflict of interest. Hence, the term often becomes subjective in nature and gives rise to various challenges.[76] First, the definition presumes the universal existence of a comparative transaction of which reference can be taken. However, such transactions may not exist in each scenario.

The Income Tax Rules however provides legislative clarity towards these related party transactions. The principles of transfer pricing provide principles to calculate the values of arm's length transactions for taxability. It recognizes five globally documented methodologies under the Organization for Economic Co-operation and Development's (OCED) Guidelines to determine the value of transactions conducted at arm's length when similar unrelated parties enter into such transactions.[77]

The Comparable Uncontrolled Price (CUP) Method is considered to be the most reliable mechanism in determining valuation of transactions. It compares the transaction value of a comparable product or service in an uncontrolled market to determine its value.[78] However, this method requires a stringent requirement that the products and the services must have high

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[71] The Companies Act, 2013 (18 of 2013) s 188.
[72] The Companies Act, 2013 (18 of 2013) s 188 (2).
[73] The Companies Act, 2013 (18 of 2013) s 188.
[74] The Companies Act, 2013 (18 of 2013) s 188.
[75] A. Ramaiya, *Guide to the Companies Act* (Vol. 2, 19th edn., Lexis Nexis 2020) pg. 1375.
[76] A. Ramaiya, Guide to the Companies Act (Vol. 2, 19th edn., Lexis Nexis 2020) pg. 1375.
[77] The Organization for Economic Co-operation and Development, 'OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations' (January 2022) < https://oecd.org/content/dam/oecd/en/publications/reports/2022/01/oecd-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-administrations-2022_57104b3a/0e655865-en.pdf> accessed 8 January 2025.
[78] OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022, Chapter II Comparable Uncontrolled Price Method <https://doi.org/10.1787/0e655865-en> accessed 8 January 2025.

comparability. Thereby, this method is not always applicable as a similar comparative transaction may not exist in every situation.[79]

The Resale Price Method refers to a method where the associated company proceeds to sell the product to a third party.[80] This selling price is termed as 'Resale Price'. After determining the resale price, the gross margin is subtracted from the resale price to determine the valuation of the transaction in an uncontrolled environment. After this, costs that are associated with the purchase, such as customs duty, are deducted. This value is considered as the arm's length price between the related parties. However, this method can be adopted purely in situations where a third party is involved; hence, matters such as services and machinery licensing might be outside this method's scope. The Cost Plus Method emphasizes on the costs of the supplier of goods and services in controlled transaction.[81] After the ascertainment of this cost, a mark-up is added to the value to take into considerations for the profits that would be incurred upon the transaction. This value is deemed to be the valuation in an arm's length transaction.

The Profit Split Method is adopted mainly for international transactions where various related parties provide the considerations in a single transaction and such contribution cannot be evaluated separately.[82] In these transactions, the profit is split between the parties based on their respective contributions. Hence, the computation of such contribution is subjective in nature as it has to be decided on a case-to-case basis and no legal framework exists to compute such contributions.

The final method that is recognized is the Transactional Net Margin Method where the Net Profit Indicators (Net Profit/cost, or sale, or assets) of the transaction is compared to a Net Profit Indicators in the uncontrolled market.[83] The differences are adjusted to find the arm's length price. This method again suffers from the presumption of the existence of a universal similar transaction.

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[79] The Institute of Company Secretaries of India, Guide to Transfer Pricing (1st edn, November, 2016) 16.
[80] OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022, Chapter II Resale Price Method <https://doi.org/10.1787/0e655865-en> accessed 8 January 2025.
[81] OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022, Chapter II Cost Plus Method <https://doi.org/10.1787/0e655865-en> accessed 8 January 2025.
[82] OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022, Chapter II Transactional Profit Split Method <https://doi.org/10.1787/0e655865-en> accessed 8 January 2025.
[83] OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022, Chapter II Transactional Net Margin Method <https://doi.org/10.1787/0e655865-en> accessed 8 January 2025.

These transfer pricing methods were utilized exclusively for international transactions till March 2013. However, these provisions were extended to certain domestic transactions that included related parties and undertaking companies from April 2013.[84]

Hence, while there exist various methods of computing the valuation of the arm's length transaction, the element of subjectivity and the presumption of the existence of a universal comparable transaction lead to various challenges in determining the valuation.

If the shares of a target company are acquired by the subsidiary and its machinery, services, goodwill etc. is being utilized by the holding company, the subsidiary will face an obstacle to raise a claim against the holding company for a fair value as such transactions are usually catered specifically to the needs of the organization and the presumption of having a universal comparable transaction in the market would be highly unlikely due to the relationship within the company.

For instance, in the case of GK Limestone, a partnership was converted into a company and its shares were sold to Ultra Tech cement to become its wholly owned subsidiary.[85] The acquiring company proceeded to utilize the mines that were licensed with the newly converted company. The court pierced the corporate veil to determine that the transaction was undertaken to guise the transaction of transfer of mining rights to prevent payment of fees for the change of licensing rights of the mine. In the present case, the corporate veil was pierced because the Supreme Court opined that the holding company would be utilizing the rights of the subsidiary company by evading regulations. This presents another dichotomy that the parent company has the option to potentially utilize the resources of the holding (the exception in the present case being illegal due to evasion of payment to the Sate) while the Courts treat subsidiaries to have a separate entity with a separate legal existence.

Therefore, while in principle related party transactions enjoy protections of being an 'arm's length transaction' the presence of subjectivity in the manner poses challenges to such implementation. Due to the current regulations, holding companies may treat such share-swap as a barter against acquisition of new resources in the company. While company law in India provides special regulations for undertakings of companies, it is evident that such protection is catered purely to the interests of the shareholders of the holding company. There exist no provisions addressing the rights of the board of the subsidiary as well as the remaining

[84] The Institute of Company Secretaries of India, *Guide to Transfer Pricing* (1st edn. November, 2016) pg. 18-28.
[85] *State of Rajasthan v Gotan Limestone Khanij Udyog P. Ltd* [2016] 4 SCC.

shareholders of the subsidiary in such transactions. Hence, the treatment of control to the subsidiary can be deemed to be theoretically treated at par with the rest of the resources of the company without additional safeguards. Therefore, various share-swap transactions may be entered between the subsidiary and the target company with the sole intention to cater to the needs of the holding with a blatant disregard towards the commercial aspect of such transactions for the subsidiary. The holding company can strong-arm such transactions due to its voting powers and completely disregard the obstacles that might be faced by the subsidiary companies.

4.3. Exemption from restrictions on Related Party Transactions by private companies

Related party transactions include holding-subsidiary relationships in the Companies Act.[86] However, the Ministry of Corporate Affairs in 2015 exempted such relationships in private companies from the ambit of related parties through a notification.[87] Due to this amendment, the audit committee will not have the power to void such transactions that exceed Rs. 1 Cr.[88] A board resolution will not be necessary for transactions between the holding and subsidiary under related party regulations.

There exists a grey area in the Indian corporate framework in the classification of a related party transactions as discussed in the previous section. The introduction of this notification inevitably leads to the presumption that no transaction entered between the holding and subsidiary company are being conducted in a controlled environment. Therefore, the test for the determination of an arm's length transaction is rendered redundant when it comes to private companies. This redundancy deems all transactions are undertaken at a fair price without the requirement of a valuation exercise. This exempts the requirement of the board's consent to such transactions. Furthermore, the board will not be required to be provide a justification to the shareholders according to Section 188(2) for incurring such a transaction. As the holding company enjoys majority stake in the subsidiary, the resolution requirement under Section 188 cannot protect the autonomy of the subsidiary.

Indian Accounting Standard 24 provides instances of related party transactions such as leasing, buying, selling, receiving and rendering of services etc.[89] These transactions can be undertaken

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[86] The Companies Act, 2013 (18 of 2013) s 2 (76)(viii)(A).
[87] Ministry of Corporate Affairs, Notification G.S.R 464(E), 5th June.2015.
[88] The Companies Act, 2013 (18 of 2013) s 177.
[89] The Institute of Chartered Accountants of India, Accounting Standards Board, *Exposure Draft: Accounting Standard (AS) 24, Related Party Disclosures* (ICAI 2017)

without the safeguards provided in the Companies Act and can further give scope for the holdings to dominate the operations of the subsidiary. While the control of the holding is diluted in these transactions, it can potentially benefit by acquiring services and utilization of the acquired company without a fair consideration to the subsidiary. The subsidiary would not be in a position to challenge such transactions due to the regulations in the market.

In principle, following the share-swap between the subsidiary and the target company, the holding company may utilize the acquisition for its benefit without providing the subsidiary any autonomy in such transactions. As India observes holdings dominate control of the composition of the board of the subsidiary, even independent directors cannot prevent such transactions as private companies are exempted from requiring board resolutions.

V. MECHANISMS TO PROTECT THE AUTONOMY OF THE SUBSIDIARY

There currently exists a dichotomy in the corporate jurisprudence related to the autonomy of subsidiaries. At one end the court recognizes the autonomy of subsidiaries while the regulations on the other hand provide ample scope to the holding company to dominate the control of the organization. Certain approaches could be adopted to resolve this dichotomy according to the author.

First, the regulations need to devise a mechanism to grant limited autonomy to the subsidiaries related to decision making. The existence of minority shareholder directors in listed companies could be refurbished to cater to the needs of all registered companies. Further, increasing the number of independent directors in the board could be introduced to combat dominance of the holding. A Veto power could be introduced to the minority and independent directors that can be exercised to protect the interests of the subsidiaries.

Second, in transactions where the shares are treated as an asset, regulations could be devised to necessitate the inclusion of all the stakeholders of the subsidiary to prevent the unilateral dilution of shares through the holding company's board. This regulation should provide an exit option for the dissenting minority shareholders and its procedure could be laid down.

Finally, the Ministry of Corporate Affairs could potentially repeal its exemption to hold subsidiaries a related party of the holding company in private companies to provide some scope

https://asbcomment.icai.org/adminDownload/19258a4fce03338fe2b73a8ec2e3c28b.pdf accessed 8 January 2025.

of autonomy. This would aid the subsidiaries to raise objection to transactions that are presumed to be entered at 'arm's length' to invoke protections under the Act such as consent of the board, mandatory justification of entering such transactions etc.

VI. CONCLUSION

The paper highlights the challenges to the autonomy of subsidiary companies in India. With the advent of favourable regulations towards share-swap, it has the further to disregard the independence of decision-making power of subsidiaries. The dominant control of the holding company due to its majority stake in voting power that often comes with the power to control the composition of the board, the subsidiary may be strong-armed into dilution of its shareholding for acquisition related transactions implemented by the holding unilaterally.

The recent relaxation of OI Rules and FEMA indicate an increase in the occurrence of such transactions in the Indian corporate landscape. While the courts have recognized subsidiaries to be independent entities from its holdings, the lack of regulatory safeguards provides potential for legal discourse towards the risk these relaxations offer towards the subsidiaries.

The preponderance of private unlisted companies in India amplifies the risks of undermining the decision-making power of subsidiaries as they do not require a special resolution and such transactions may be approved solely by the board that is often at times controlled by the holding. The exemption from subsidiaries of a private company from being a related party escalates the position for holdings to dominate such transactions. The limitations to determine the quantum/framework of an arm's length transaction complicates the legal position of subsidiary autonomy in a practical sense. Certain developments in the legal sphere could be utilized to address these challenges through the creation of a robust regulative framework that prevents the domination of the holding in such transactions in the future and these regulations must aim to provide scope of dialogue for the subsidiary to prevent a unilateral change in the structure by the holding company.