

No hurdles to outbound investments for cos

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INDIA TODAY is a global player, investments in India by foreign companies are as important as investments made outside India by an Indian company. Further, acquisitions, be it local or cross-border helps India Inc to move forward.

Unfortunately, the concept paper on revamping the Companies Act, 1956, may cause a few impediments.

The Companies (Amendment) Bill, 2003, had put an end to two-tier structures. It had proposed that a subsidiary cannot have another subsidiary. India Inc, was then up in arms against this proposal, and rightfully so.

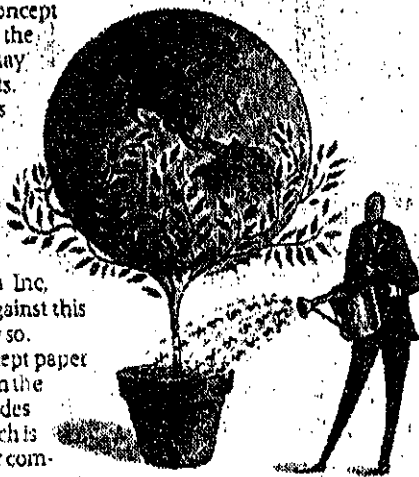
Sad to say, this concept paper is drawn more or less on the same lines. It provides that: No company which is a subsidiary of another company shall, after the commencement of this Act, be a holding company. In other words, a subsidiary cannot have a subsidiary. However the concept paper has made one exception.

A proviso states: A company, which is a subsidiary of another company, may be a holding company of a body corporate incorporated outside India. In other words, outbound investments will not be affected. For example, if a software company in India (Co A), has a subsidiary (Co B) that carries out BPO operations. Co B, would be permitted to set up its operations abroad, by setting up a subsidiary (Co C) in Mauritius.

However, if Co B wishes to have another subsidiary in India, this would not be permitted. The saving grace, this proposal will not have a retrospective effect, but will come into force only once the new Companies Act, is

enacted. This proposal has several ramifications. To begin with, it is illogical to prohibit Co B from setting up a subsidiary in India, but to permit it to set up subsidiaries abroad.

In our example, Co C, would in turn be allowed to have downward subsidiaries abroad. The Mauritius subsidiary, would be able to have a sub-



subsidiary in Philippines, China and other countries. A chartered accountant quips: "Does it mean that the draftsmen have more faith in legislation of other countries?"

Second, this proposal will impede further growth. Kartik Ganapathy, corporate advocate, Nishith Desai Associates, states: "It will not be possible for Co B, that is a subsidiary, to acquire other BPO companies in India. Acquisition through a share transfer is much more simple than an amalgamation that involves a lengthy court process. After enactment, inorganic growth via acquisitions will be impossible."

While existing structures will not be affected, problems will arise in the future mergers and acquisitions, if the target company has more than one step-down

subsidiaries. Thus, while the doors will continue to remain open for outbound expansion and growth, growth within India will be stunted. A few legal practitioners have also raised doubts on inward investments into India. The reason is the definitions contained in the concept paper.

Most MNC's that invest in India are global conglomerates, having several subsidiaries in different countries.

For eg, the apex holding company of the MNC group may be in the US. It could be having subsidiaries in UK, Singapore and China. If, the UK company wishes to invest in India, will it be allowed to do so, even if it is a subsidiary of the parent company of the group?

A subsidiary cannot have another subsidiary, in India. But does this restriction cover a subsidiary of a foreign company that wishes to have a subsidiary in India? The confusion arises, as the definition of a body corporate is wide enough to cover a company incorporated outside India.

Shefall Goradia, head-business structuring division, Nishith Desai Associates opines, that a subsidiary outside India, of a foreign parent, will not be affected. She says: "The concept note, has drawn a distinction between the term 'body corporate' and 'company'. A company only refers to a domestic company, incorporated in India. Only a subsidiary of such a company, cannot have downward subsidiaries in India."

"Ideally there should be a clarification to the effect that corporate entities registered and incorporated abroad will not be covered by the Indian Companies Act, for the purpose of determining the pyramid structure of the holding company and its subsidiaries within India," states another consultant.