

GROUP COMPANIES - ANALYSIS OF THE CONCEPT AND ITS IMPLICATION IN INDIA, UK, AND US WITH SPECIAL REFERENCE TO INTER CORPORATE TRANSACTIONS OF SMALL COMPANIES UNDER COMPANIES ACT, 2013 - THRESHOLDS AND EXEMPTIONS: A CROSS-JURISDICTIONAL ANALYSIS

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ABSTRACT

A **Group Company** is simply a company having **control** over other types of companies. There are various regulatory, legal, and commercial advantages of forming such a structure. It is important to understand the various relations running across group companies under a common group to understand the group company structure in its entirety. **Companies Act, 2013** is the primary legislation in India which deals with various corporate matters, though it does not define group company it does define the various entities forming a part of this structure. **Small Companies** under the Companies Act, 2013 have fewer compliance requirements, and further, the threshold under the act for such companies has been widened via a central government notification. **Inter-Corporate transaction** under the Companies Act, 2013 are inclusive of investments, loans, securities, or guarantees are given by one company to the other. Companies Act, 2013 is largely inspired by the comprehensive United Kingdom legislation i.e., **Companies Act, 2006**. This act covers almost everything to do with companies it is the longest piece of legislation in British parliamentary history extending to a whopping seven hundred pages and one thousand three hundred sections. The definitions given under this act are provided exhaustively, ex: section 1159 and 1162 read with schedule 6 and 7 respectively gives us a broad understanding of what comprises of a **subsidiary and holding company**. Each of the fifty states In the US has a different company state law, based on which the articles of incorporation are filed in the specific state. More than sixty-five percent of all fortune companies and more than half of US Publicly listed companies are incorporated in Delaware because of the various advantages offered by the **Delaware General Corporate Law**. Unlike the other two company legislations of India and the United Kingdom that are comparatively exhaustive, this act provides for ample flexibility.

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Keywords: Company, Jurisdiction, Corporate.

INTRODUCTION

Across various jurisdictions, a group company is usually defined as being a company that has a certain percentage of control over the various other types of companies. Control concerning this subject matter usually entails the power to appoint a majority of the directors of a company. In general, a group company is an economic entity comprising of several companies which are controlled by this single economic entity. The companies forming a part of the group company can include holding companies, subsidiaries of the holding company, and subsidiaries of such subsidiaries and Joint Ventures. There are various regulatory, legal, and commercial reasons for forming such a structure, and mainly helps better manage various enterprises and mitigate losses.

WHY GROUP STRUCTURE?

Separation of assets and liabilities: The assets and liabilities of the various group companies are treated separately. The assets of other group companies cannot be claimed just because they are part of the same group. Poor financial performance by one company will not impact the performance of other well-performing group companies.

Varied investment opportunities: Investors can assess the performance of various group companies and can accordingly make a sound investment decision. This way an investor can limit his liability as the performance of one group company will not have an impact on the others. The investors can also make investments at a group level and this will have a trickle-down effect across the various holding companies, subsidiaries, and joint ventures,

Loan and Guarantees: A group company instead of taking loans from banks and financial institutions at a steep rate can take loans from any one of the group companies at a minimum market rate. A sister or a holding company can further provide guarantees for a loan taken by the group company and this arrangement is most often insisted by a bank or financial institution.

Better Management: As the various group companies have a separate legal identity the management can be decentralized, this way having better control and coordination over each of the company's operations and governance. There is hands-on control over every group

company. Centralized management across various companies may not be able to address entity-specific problems.

Sale of a company: A company can be established in a group structure with the sole purpose of it being sold in the future.¹ This does not disrupt the functioning of other group companies and the funds from such sales can be distributed among them.

Tax benefit: Most of the time across various jurisdictions there is a certain tax exemption for transactions across group companies.² Hence not only will the group companies benefit out of such transactions but also at a lower cost than normal, ex: transferring of assets across two group companies or supplying of finished goods or raw goods from one group company to another.

Centralized asset management: The group can hold various assets which can be used by the group companies³. This can include assets such as property or intellectual property that can be leased or licensed by the group to the group companies. This way assets are better utilized and liability of ownership is dealt with at a group level.

GROUP COMPANY RELATIONSHIP

To understand the concept of a Group Company in its entirety it is important to explore the variety of relationships between companies under a certain group. The most common relationship between group companies are as follows:

Holding and Subsidiary company, this includes Wholly Owned Subsidiaries: In this relationship, a holding company will own at least fifty percent (50%) of shares in a subsidiary. In a wholly-owned subsidiary, the holding company owns a hundred percent (100%) of the shares of a subsidiary company.

Sister Companies: Two companies controlled by a common parent company are sister companies. These sister companies can hold each other's shares, but it is usually less than fifty percent (50%).

¹ Darwin Gray, 'What are the Benefits of a Group Company Structure?' (7 August 2019) <<https://businessnewswales.com/what-are-the-benefits-of-a-group-company-structure/>> accessed 15 December 2021

² Ibid

³ Ibid

Investing and Associate Company: The investing company owns not less than twenty percent (20%) but not more than fifty percent (50%) of the shares in an associate company. This need not be a subsidiary and can include a joint venture relationship. Although in a joint venture relationship any shareholding less than twenty percent (20%) does not include an investing and associate relationship but can still be a joint venture.

Holding Company-Sectorial Operating Company: This kind of three-layered structure is beneficial when a group holding company has activities across various sectors. This holding company can have two or more sectorial companies in which it owns a hundred percent (100%) of the shareholding, while these sectorial companies can own not less than fifty percent (50%) of shares in one or more sectorial operating companies. This ensures better management and division of activities across various market sectors.

INDIAN CONTEXT

In India, at present, the main piece of legislation concerning the affairs of a company is the Companies Act, 2013. This act refers to the various relations among group companies excluding holding and subsidiary companies although it does not define nor make a reference to group companies. Although on November first, 2013 a circular was issued i.e., 'Circular 1 of 2013 – Consolidated FDI Policy', effective from 05-04-2013 by the Government of India, stating that the Foreign Direct Investment ('FDI') policy had been reviewed and it has decided to incorporate the definition of 'group company'.⁴ Accordingly, a group company was defined as two or more enterprises that are directly or indirectly in a position to exercise twenty-six percent (26%) or more voting rights in other enterprises or appoint more than fifty (50%) of the members of the board of directors in such other enterprise⁵. The reason for such addition to the FDI policy is not given although it was speculated that this was meant to bridge the gap in the foreign policy that was being abused by big retailers such as Walmart while sourcing to Indian companies⁶. The Ministry of Corporate Affairs on first January 2013 had appointed a one-man committee, comprising of former Chief Justice of Punjab and Haryana High Court i.e., Mukul Mudgal to probe whether the retail giant Walmart had engaged in alleged lobbying

⁴ Rudra Narayan Kaur, 'Foreign Direct Investment (FDI) in India –definition of 'group company' (1 November 2009) <<https://rbi.org.in/SCRIPTs/NotificationUser.aspx?Id=8551&Mode=0>> accessed 16 December 2020

⁵ Ibid

⁶ 'Govt clarifies what group company means' Time of India (India, 4 June 2013)

activities and other incidental matters.⁷ Bharti Retail an enterprise owned by Bharti Enterprises had entered into a joint venture agreement with Walmart and hence forming Bharti Walmart Ltd.⁸

The FDI rules state that trading among companies of the same group is allowed, although it mandates that such sales should not exceed twenty-five percent (25%) of the total turnover of the wholesale venture.⁹ The Chief Executive Officer of Bharti Walmart Ltd., Mr. Raj Jain was summoned by the Mukul Mudgal commission, during such deposition he stated that Walmart was deriving about forty percent (40%) of its turnover through sales to Bharti Retail.¹⁰ It was reported by the Times of India that he further denied violation of any rules as “what those group companies” are not clearly defined.¹¹

DEFINITIONS UNDER COMPANIES ACT, 2013

It is imperative to take note of definitions under the Companies Act, 2013 about the various companies forming a part of the group structure. Section two gives us a insight into the various terms defined in the context of this act¹². Associate Company is defined as a company over which the other company has a significant influence, the company not being a subsidiary of the other company but can be a joint venture company. While a holding company is simply viewed as a company having subsidiary companies.¹⁴

This act has gone into greater detail while describing a subsidiary company. Subsidiary companies are those companies in which the holding company controls the majority of the board of directors or controls more than one-half of the share capital¹⁵.

Control, as explained, includes the right of an individual or a group of people by mutual consent to appoint or remove the majority of the directors or to be in control of the management or the

⁷ Shruti Srivastava, ‘Walmart to Mudgal panel: Lobbied in US not India’ The Indian Express (Delhi, 17 May 2013).

⁸ Rudra Narayan Kaur, ‘Foreign Direct Investment (FDI) in India –definition of ‘group company’ (1 November 2009) <<https://rbi.org.in/SCRIPTs/NotificationUser.aspx?Id=8551&Mode=0>> accessed 16 December 2020.

⁹ Ibid

¹⁰ Ibid

¹¹ Ibid

¹² Companies Act, 2013

¹³ Ibid s. 2(6)

¹⁴ Companies Act, 2013 s. 2(46)

¹⁵ Companies Act, 2013 2(87)

policy decisions by virtue of their shareholding or management agreement or shareholding agreement or voting agreement. ¹⁶ Such shareholding may not be of the company alone but can include one or more subsidiaries or of the subsidiaries alone. The explanation to section 2 (87) of this act elaborating on subsidiary companies specifies that “company” includes any body corporate and section 2(11) enumerates what does not include a company i.e., except for a company incorporated outside India. ¹⁷ By way of this logic, a foreign company can hold a subsidiary incorporated in or outside India, and an Indian holding company can have a subsidiary incorporated outside of India, even if it’s not registered as a company.

APPLICABLE PROVISIONS

A brief run-through of some of the provisions applicable to holding and subsidiary companies will help us better understand group companies; hence they are enumerated as follows:

Related Parties transactions (holding and subsidiary company): Transactions between a holding company and its subsidiaries or associate company will not come within the ambit of ‘related-party’ as defined under section 2(76) of the act, except valuation under Central Excise Act, 1944 where they are treated as related parties. ¹⁸

Non-Holding of parent company shares by subsidiary and exceptions: A subsidiary company cannot hold shares of its holding company, even if it is through its nominees, and neither can the holding company allot shares to its subsidiary company ¹⁹. Although the subsidiary company can hold shares of its holding company as a legal representative of a deceased member of the shareholding company or as a trustee or if it became a shareholder before it was a subsidiary and can vote on matters as such legal representative or trustee. ²⁰

Deemed public company: In certain scenarios, a private subsidiary of a public holding company will be deemed to be a public company ex: section 204 specifies that a secretarial audit applies to subsidiaries of a private company, even though such provision is usually not applicable to private companies incorporated under this act. ²¹

¹⁶ Companies Act, 2013 s. 2(27)

¹⁷ Companies Act, 2013

¹⁸ Ibid

¹⁹ Companies Act, 2013 s.19

²⁰ Ibid

²¹ Companies Act, 2013

Small Companies and Inter Corporate transactions: “Small Companies” as defined under section 2 (85) of the act includes private companies whose paid-up share capital is not more than fifty lakh rupees and can be extended up to ten crore rupees, as well as a turnover not exceeding two crore rupees and which can be extended up to one hundred crore rupees.²² On 1st February while the Finance Minister Mrs. Nirmala Sitharaman was presenting the union budget, she proposed revising the definition of small companies by raising the thresholds of a small company to a paid capital of two crore rupees and a turnover up to twenty crore rupees²³.

This way more private companies will fall within the ambit of small companies and hence have fewer compliance requirements. According to this proposal the central government passed a notification GSR 92(E) dated first February 2021 and hence amending Companies (Specification of Definitions Details) Rules, 2014. Accordingly, clause (t) added to subrule one of rule 2, and the paid-up capital was enhanced to two crores, whereas turnover to twenty crore rupees.²⁴

While intercorporate transactions could be interpreted as investments, loans, securities, or guarantees given by one company to the other. The word company as given under section 2(20)²⁵ includes companies incorporated under the Companies Act, 2013 or any other previous company law and hence includes small companies. As per 186 of the present company law investment cannot be made through more than two layers of an investment company. Investment companies include those companies primarily engaged in the dealing of shares, debentures, or other securities.²⁶ Although such investment through two layers of an investment company is valid when such company is incorporated outside or when a subsidiary in India has to incorporate an investment subsidiary according to the given rules, regulations, or laws in force.²⁷ A company cannot give loans, securities, guarantees or make investments by way of securities or acquisition in its parent company, subsidiary, or Joint Venture beyond sixty

²² Ibid

²³ Sushil Kumar Antal, ‘New Definition of Small Company Under Company Act, 2013’ (march 2021) <https://taxguru.in/company-law/definition-small-company-companies-act-2013.html> accessed 16 December 2021

²⁴ Ibid

²⁵ Companies Act, 2013

²⁶ Ibid Explanation (a)

²⁷ Companies Act, 2013 s. 186

percent of its paid-up share capital, securities premium account, and free reserves or hundred percent of its securities premium account and free reserves, whichever is more ('normal threshold').²⁸ If the above-mentioned thresholds are to be exceeded a special resolution is to be passed in a general meeting i.e., three fourth of members present and voting.²⁹

Companies should disclose to their members in their financial statement the details of such loans, securities, guarantees, and investments, as well as their purpose.³⁰ No such above-mentioned transaction should be made without the passing of a resolution by all the members of the board.³¹ In some cases, prior approval of the public financial institution may have to be taken according to terms of the loan granted, although such approval is not required when the aggregate of loans, securities given, and investments made does not exceed the normal threshold or there are no outstanding loan installments or interest due.³² Further, if a company has defaulted paying a deposit or interest it shall not give any loan, security, or guarantee and make any acquisition.³³ The rate of interest for such loans should not be less than interest provided by government security in the last three, five, or ten years, whichever is closer to the tenure of the loan.³⁴ No companies under section twelve of the Securities and Exchange Act, 1992 and such other companies as notified by the central government can make such intercorporate transactions beyond the normal threshold. Companies shall keep a register of these intercorporate transactions by the form MBP-2.³⁵ The provisions in section 186 do not apply to Banking Companies, Housing Finance Companies, Insurance companies, and Non-Banking Financial Companies.³⁶ If a company contravenes any one of these provisions under section 186 it will be liable to pay a fine of a minimum of twenty-five thousand rupees and which can extend to up to five lakh rupees.³⁷ While an officer in default will be punished with

²⁸ Ibid (2)

²⁹ Ibid (3)

³⁰ Ibid (4)

³¹ Ibid (5)

³² Ibid

³³ Ibid

³⁴ Companies Act, 2013 s. 186(7)

³⁵ Vikram Singh Sirahi, 'Intercorporate Loans and Investments under Companies Act, 2013' (10 July 2020) <<https://taxguru.in/company-law/inter-corporate-loans-investments-companies-act-2013.html>> accessed 16 December 2021

³⁶ Companies Act, 2013

³⁷ Ibid

imprisonment up to two years with a fine of a minimum of twenty-five thousand rupees and a maximum of one lakh rupees.³⁸

CASE LAWS

- The Orissa High Court in *Industrial Development Corporation and Another vs. Reg Provident Fund Commissioner and another* 2002 LLR P. 275 confirmed that a holding company is not liable for provident fund dues of a subsidiary company.
- *Vodafone International Holdings BV v. Union of India*, [2012] 1 S.C.R. 573 the Supreme Court held that a Holding company and subsidiary company are considered as separate legal entities, and a subsidiary is allowed decentralized management. Vodafone case further referred to a decision of the US Supreme Court in the *United States v. Best foods* 524 U.S 51 (1998). In that case, the US Supreme Court explained that as a general principle of corporate law a parent corporation is liable for the acts of its subsidiary.
- In *K.K. Modi Investment & Financial Services v. Apollo International*, 2014 SCC OnLine Del 2000, the single judge bench rejected the application for deletion of the non-signatory group companies from the list of parties and rejection of the plaint on their behalf.³⁹ This court passed such order based on the judgment in the case of *Utair Aviation v. Jackson Airline* (2012) 29 DRJ 679, here the Delhi High Court held that privity against a stranger to the contract can be established by considering factors such as admission, awareness, acknowledgment, participation, and receipt of benefits⁴⁰. Further, the courts in such a case must determine “whether the party can be said to be a stranger to a contract or where the plea is taken only to defeat the claims of the party”, this can be concluded by looking into the circumstances surrounding such contract.⁴¹

UNITED KINGDOM PERSPECTIVE

India’s Companies Act,2013 is to large extent inspired and modeled after United Kingdom’s Companies Act, 2006. This is a very comprehensive piece of legislation and covers almost

³⁸ Ibid s. 186(13)

³⁹ Sidhant Kumar, ‘Group Company Doctrine in India: Holding Labyrinth Corporate Structures Accountable’ (15 January 2020) <<https://www.barandbench.com/columns/group-company-doctrine-in-india-holding-labyrinth-corporate-structures-accountable>> accessed on 17 December 2021

⁴⁰ Ibid

⁴¹ Ibid

everything to do with companies. It is one of the central company laws in the United Kingdom ('UK'). It is the longest piece of legislation in British parliamentary history extending to a whopping seven hundred pages and one thousand three hundred sections. It has been successful in codifying some common law principles.⁴² This act is implemented by the Department of Business, Innovations, and Skills.⁴³ Some of the key changes brought about by this act include- better administration of companies, easier incorporation process, integrating the systems of England and Northern Ireland, Introduction of European Union directives in the law, and so on.⁴⁴

DEFINITIONS UNDER COMPANIES ACT, 2006

Perusing through the definitions consequential to group companies, as given under the Companies Act, 2006 will better help us understand this company structure in light of the UK legal framework. Unlike the Indian companies act this act defines group undertakings, they include parent companies or subsidiaries or subsidiaries of parent companies, belonging to such undertaking. Section 1159 of the act⁴⁵ read with schedule six help to understand the concept of subsidiary companies. A company is a subsidiary of a holding company if it holds the majority of the voting rights or if it has the right to appoint or remove the majority of the directors or controls the majority of the voting rights in it under an agreement with the other members.⁴⁶ Such a right to appoint or remove the majority of the directors includes the right to appoint or remove directors having such majority voting rights in a board meeting or any other meeting, as well as this right of removal or appointment will only be taken into account if it can be exercised by only one person.⁴⁷ The right to appoint directors is reflected from the following appointment of such person as a director on such direction given or the directorship held by the company itself.⁴⁸ Shareholding/Voting rights of the parent company's subsidiaries will be deemed to be that of the parent company.⁴⁹ It is further clarified that members of 'wholly-owned subsidiary' include the holding company alone except for its other subsidiaries and the

⁴² 43 Gocardless, 'What is the Companies Act, 2006' (2006) <<https://gocardless.com/guides/posts/what-is-the-companies-act-2006/>> Accessed on 16 December 2021

⁴³ Ibid

⁴⁴ Ibid

⁴⁵ Companies Act, 2013

⁴⁶ Ibid s. 1159

⁴⁷ Ibid (1)

⁴⁸ Companies Act, 2006 Schedule 6

⁴⁹ Ibid

wholly-owned subsidiaries of the other subsidiaries or the nominees of the other subsidiaries and its wholly-owned subsidiaries.⁵⁰

Such rights held by a nominee or by a person/entity by way of security are exercisable by such nominee or person on instructions of such parent company or in the interest of it or for the preservation of the value of such rights.⁵¹ In the Companies Act, 2006 reference is made to the term 'parent company' instead of holding company as made in the Indian Companies Act, 2013. Parent undertaking as defined in section 1162 read with schedule seven.⁵² The contents of this⁵³ provision are the flipside of section 1159 and also includes other provisions such as – the parent company has the right to exercise a dominant influence over the subsidiary by way of giving directions with regards to financial or operational policies and the board of directors has to comply with it irrespective of the repercussions.⁵⁴ Undertakings under this act include both body corporates and unincorporated entities.⁵⁵ Such dominant undertaking can be established by articles of the subsidiary or by way of control contracts.⁵⁶ Control contracts are simply contracts authorized by the articles or the law under which the subsidiary is established.⁵⁷ A company managing a subsidiary on a unified basis is also referred to as a parent company.⁵⁸

While an 'investing company' is simply a public company that gives notice to the registrar of its intention to continue business as an investing company and such can be revoked by this company by again sending a notice expressing its unwillingness to be an investment company.⁵⁹

APPLICABLE PROVISIONS

The notable provisions of the Companies Act, 2006 about undertakings comprising of the group companies are as follows:

⁵⁰ Companies Act, 2006 s. 1159(2)

⁵¹ Companies Act, 2006 Schedule 6

⁵² Companies Act, 2006

⁵³ Companies Act, 2006 s. 1161

⁵⁴ Ibid

⁵⁵ Ibid

⁵⁶ Companies Act, 2006 Schedule 7

⁵⁷ Ibid

⁵⁸ Ibid

⁵⁹ Companies Act, 2006 s. 833

- **Non-Holding of parent company shares by subsidiary:** Section one 136 of this act disallows subsidiaries from being members of their parent company or the allotment of shares to such subsidiaries by its holding company.⁶⁰ This provision is not applicable if such subsidiary was a member of its parent company before such provision became applicable or the subsidiary holds shares in the capacity of a legal representative or trustee or is carrying on the business of dealing in securities.⁶¹ Although Section 611 states that a wholly-owned subsidiary can transfer shares to its holding company as a consideration, in return for such holding company transferring non-cash assets to it.⁶²
- **Financial assistance by public subsidiary:** Under section 679 of this act, a public company trying to acquire shares of a private company cannot take financial assistance from its public subsidiary or give financial assistance to a person who has acquired shares of a private company and has incurred liabilities in doing so.⁶³ Although such financial assistance by a public company is allowed when it is for purposes other than the acquisition of shares/ discharging of liability or such financial assistance/ discharge of liability is for a larger purpose incidental to the parent company.⁶⁴
- **Consolidated accounts of the group company and Related Party Disclosures:** Section 405 provides that when a parent company is preparing a consolidated account of the group company the subsidiary undertakings should be included in it unless it is not material for giving a true view or severe long-term restrictions hinder rights over the assets or management of such subsidiary company or the interest in the subsidiary has been held for the sole purpose of its resale.⁶⁵ As given under section 413 parent companies preparing group accounts should along with disclosure of related party transactions i.e., credit, advances, and loans to directors, include advances, credits, and guarantees from any subsidiaries, as well as the parent itself, to the parent's directors.⁶⁶

CASE LAWS

- In *Lungowe v Vedanta Resources plc* [2019] UKSC the UK Supreme Court allowed action in England to be initiated against Zambian subsidiary i.e. the defendant.

⁶⁰ Companies Act, 2006

⁶¹ Ibid s. 136(1)

⁶² Companies Act, 2006

⁶³ Ibid

⁶⁴ Ibid s. 679 (2) & (4)

⁶⁵ Companies Act, 2006

⁶⁶ Ibid

Confirming what was reiterated in *Okapi & Ors v Royal Dutch Shell plc & Anr* [2021] UKSC 3 i.e. the respective claimant could file a suit against the foreign subsidiary of a UK-based parent company.⁶⁷

- In *Adams v Cape Industries plc* [1990] Ch 433 the court, in this case, rejected the single economic unit argument made and also the approach that the court will pierce the corporate veil “if it is necessary to achieve justice” by impactfully reasserting the application of limited liability and the separate legal entity doctrine in regards to corporate groups.⁶⁸

UNITED STATES PERSPECTIVE

The United States of America(‘US’), often known as the land of opportunities has no one uniform corporate code. Each of the fifty states In the US has a different company state law, based on which the articles of incorporation are filed in the specific state. Companies in the US are subject to state law, federal law, regulations of government agencies such as the Securities and Exchange Commission, and regulators including respective stock exchanges.⁷⁰

The federal law ensures some form of uniform regulation about matters such as dealing with shares and other securities, as well as governance matters.⁷¹ The two main federal laws include the Securities Act of 1933 and the Securities Exchange Act of 1934. The US Constitution allows companies to incorporate in any state regardless of where their headquarters is located.⁷³

Delving into each one of the fifty states’ companies laws is a tedious and timely process. More than sixty-five percent of all fortune companies and more than half of US Publicly listed companies are incorporated in Delaware, ex: Apple, Facebook, Yelp, Coca-Cola, and so on.⁷⁴

⁶⁷ Dechert LLP, ‘Supreme Court confirms UK parent company liability for acts or omissions of a foreign subsidiary: considerations for due diligence, restructurings and compliance’ (4 March 2021) <<https://www.lexology.com/library/detail.aspx?g=a2e2f87f-62fa-4848-9584-63419afa5c83>> Accessed on 16 December 2021

⁶⁸ simplestudying, ‘Adams v Cape Industries Plc [1990] Ch. 433’ <<https://simplestudying.com/adams-v-cape-industries-plc-1990-ch-433/>> Accessed on 16 December 2021.

⁶⁹ ilp Abogados, ‘The Essential Corporate Law in the United States (USA)’ (15 July 2018) <<https://www.ilpabogados.com/en/the-essential-corporate-law-in-the-united-states-usa/>> Accessed on 16 December 2021

⁷⁰ Ibid

⁷¹ Sabastian Niles, ‘What are the main legislative, regulatory and others sources regulating corporate governance practices?’ <<https://iclg.com/practice-areas/corporate-governance-laws-and-regulations/usa>> Accessed on 16 December 2021

⁷² Ibid

⁷³ Ibid

⁷⁴ Christopher Wink, ‘64% of Fortune 500 firms are Delaware incorporations: here’s why’ (23 September 2014) <<https://technical.ly/delaware/2014/09/23/why-delaware-incorp>> Accessed on 16 December 202

Delaware General Corporation Law ('DGCL') is the most famous corporate state law in the US, if not the world.

WHY DELAWARE GENERAL CORPORATION LAW?

Statute-The DGCL is reviewed every year by the Delaware legislature to keep up with the current changes⁷⁵. The statute is not exhaustive or prescriptive like most countries' corporate law, rather it has a few mandatory provisions, and otherwise, companies can be flexible in carrying on their business.⁷⁶

The Delaware Court of Chancery is one of the most renowned courts in the world. This court has specific jurisdiction over corporate matters and has delivered many notable judgments in this respect, which is cited by other state courts in the US and courts around the world.⁷⁷ There is no jury present here but only five judges, each one having adequate understanding and knowledge of Delaware business law.⁷⁸

Legal Precedent - The Court of Chancery and the Supreme Court of the state have a history of giving judgments with proper reasons to support them and hence leading to the accumulation of a significant number of precedents.⁷⁹ This helps guide companies and their advisors and they can better predict the outcome of a legal matter. There are also various other settlement methods provided.⁸⁰

Tax benefits - taxable income earned anywhere else by a Delaware corporation can be made non-taxable income in Delaware, this is often referred to as a "Delaware loophole".⁸¹

Flexible - There is no need to live in Delaware to incorporate a company or a local address, as long the company has a Delaware registered agent.⁸²

⁷⁵ Delaware Government, 'Why Businesses Choose Delaware' <<https://corplaw.delaware.gov/why-businesses-choose-delaware/>> Accessed on 16 December

⁷⁶ Ibid

⁷⁷ Ibid

⁷⁸ Ibid

⁷⁹ Sabastian Niles, 'What are the main legislative, regulatory and others sources regulating corporate governance practices?' <<https://iclg.com/practice-areas/corporate-governance-laws-and-regulations/usa>> Accessed on 16 December 2021

⁸⁰ Ibid

⁸¹ Ibid

⁸² Ibid

Efficient Incorporation - Delaware's state revenue is largely made up of incorporation fees and hence they have a specialized division of corporations. This department is open fifteen hours a day and also offers special expedited services.⁸³

DEFINITIONS

Unlike the Indian or UK Companies Act where certain terms are defined on a general basis, DGCL defines terms only in the context of a certain subject matter contained in the section or sub-chapter ex: definition of 'subsidiary' in the context of inspection of books and records or a 'holding company' in context of mergers or 'corporations' for indemnification of officers, employees and agents via insurance.⁸⁴ Hence it would be futile to delve into definitions specified in this act, although it is of benefit to conceptualize the business vehicles forming a part of the group company. Overseas or US group companies can set up subsidiaries or parent corporations or limited liability companies('LLC') in Delaware under the DGCL.⁸⁵ There are some common features of both Delaware corporation and LLC and yet they are distinct in a manner.⁸⁶

The common features are as follows:

Limited Liability:⁸⁷ Both members of a LLC and a corporation have limited liability to the extent of their membership interest and shareholding respectively. Hence the members or shareholders are not personally liable.

Perpetual Succession:⁸⁹ as mentioned under section 122 of the DGCL companies have perpetual succession and can incorporate corporations of any type.⁹⁰ Such a company and LLC will continue to exist irrespective of change in ownership or promoters.

The distinct features are as follows:

⁸³ Ibid

⁸⁴ Delaware General Corporate Law s. 220, s. 251, s. 132

⁸⁵ William H Clark Jr, Remy Nshimiyimana and Vilena Nicolet, Faegre, Drinker Biddle & Reath LLP, 'Establishing a business in the United States: Delaware' (1 May 2021) <[https://uk.practicallaw.thomsonreuters.com/05549254?transitionType=Default&contextData\(sc.Default\)&firstPage=true](https://uk.practicallaw.thomsonreuters.com/05549254?transitionType=Default&contextData(sc.Default)&firstPage=true)> Accessed on 17 May 2021

⁸⁶ Ibid

⁸⁷ Ibid

⁸⁸ Ibid

⁸⁹ Ibid

⁹⁰ Ibid

Taxation:⁹¹ the company will be taxed on their income as well as the shareholders have to pay taxes on any dividends received by them, while an LLC does not have to pay taxes on an enterprise level the members have to pay taxes on a portion of the income received by them from the LLP.⁹² The members of an LLC would have to pay tax on the LLC's income even if it suffers a loss.⁹³

Management:⁹⁴ a company is managed by the board of directors, while some major decisions would require the consensus of the shareholders.⁹⁵ An LLC will be managed by the members or such officials appointed by the members.⁹⁶

APPLICABLE PROVISIONS

Unlike the Companies Act, 2013 and Companies Act, 2006 the DGCL does not include provisions enumerating the relationship between a subsidiary or parent company or between any types of companies belonging to the same group or transactions specific to a certain type of group company. The intention of the Delaware legislature the DC was not to provide for exhaustive or prescriptive provisions but to provide utmost flexibility to the companies incorporated under this act. In absence of the above-mentioned provisions the general provisions about such group companies are as follows:

Powers of a company incorporated under Delaware General Corporate Law: Section 122⁹⁷ enumerates all the powers of a company under this act. Some of the power's worth mentioning include –

- The right to perpetual succession i.e. right of the company to carry on irrespective of the change in ownership or members or promoters.⁹⁸

⁹¹ William H Clark Jr, Remy Nshimiyimana and Vilena Nicolet, Faegre, Drinker Biddle & Reath LLP, 'Establishing a business in the United States: Delaware' (1 May 2021) <[https://uk.practicallaw.thomsonreuters.com/05549254?transitionType=Default&contextData\(sc.Default\)&firstPage=true](https://uk.practicallaw.thomsonreuters.com/05549254?transitionType=Default&contextData(sc.Default)&firstPage=true)> Accessed on 17 May 2021

⁹² Ibid

⁹³ Ibid

⁹⁴ Ibid

⁹⁵ Ibid

⁹⁶ Ibid

⁹⁷ Delaware General Corporate Law

⁹⁸ Ibid s. 122

- Right to sue and be sued- Every such company has the right to sue or be sued in its name. This is inclusive of all types of proceedings such as arbitative, administration, or judicial.⁹⁹
- Appointing agents or officers- Companies have a right to appoint officers and agents and adequately pay them.¹⁰⁰ This also includes a resident agent of overseas or domestic companies as given under section 132.¹⁰¹
- Carry on operations- A company has a right to carry on its business operation within the state and outside of the state, which is inclusive of business operations carried out overseas.¹⁰²
- Adopt, repeal or amend bylaws- bylaws are internal laws of a company drafted by it. The act gives them enough flexibility to amend or repeal them.¹⁰³
- Incorporating, managing, and promoting all types of companies- this is inclusive of rights to incorporate, promote and manage parent companies or subsidiaries or LLCs.¹⁰⁴
- Participate in a joint venture or a partnership or a limited liability partnership or any other associations: this is also inclusive of such undertakings which can establish by itself such as subsidiary or parent company.¹⁰⁵
- Lend and borrow money for corporate purposes: this includes investing of the companies' funds and dealing or giving of real and personal property as security for loans.¹⁰⁶

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Section 132 of this act is an important provision as it allows domestic and foreign companies to operate without actually running operations or having a registered office in Delaware via a registered agent.¹⁰⁷ The registered agent of domestic and foreign companies has to comply with certain requirements such as – it has to have a place of business or being present at a

⁹⁹ Ibid (2)

¹⁰⁰ Ibid (3)

¹⁰¹ Ibid (5)

¹⁰² Ibid (8)

¹⁰³ Ibid (6)

¹⁰⁴ Ibid (10)

¹⁰⁵ Ibid (11)

¹⁰⁶ Ibid (14)

¹⁰⁷ Delaware General Corporate Law

certain location in Delaware so that it can receive various services and perform the functions of an agent.¹⁰⁸

Transact business for a foreign company and forward services to the various companies it is a registered agent for.¹⁰⁹ Further, it has to comply with the regulations issued by the secretary regarding the identification of the company's contacts and the individuals comprising the company for which he/she is a registered agent.¹¹⁰ Send such annual report to the company for which it is a registered agent as given section 502 of this act.¹¹¹ Additionally, the registered agent must hold a Delaware business license and upon the secretaries' request identify or enable communication with such corporation.¹¹²

DISSOLUTION PROCESS IN GENERAL

Understanding the basic dissolution process of a company incorporated in Delaware is important, as this will determine If a company or person incorporates any type of company under this act. If this process is tedious then companies may rethink their decision, especially if such companies are incorporated for a certain assignment or project. By section 275¹¹³ the dissolution process is quite easy and is as follows:

- The Board of directors of such company if they are of the judgment that the company is to be dissolved, will hold a board meeting to this effect, and if such a majority vote is passed then notice regard regarding such resolution and holding of a meeting of stockholders should be sent to every stockholder.¹¹⁴
- All of such stockholders are entitled to vote at the meeting if so, pass a majority vote in favour of the proposed dissolution, then a certificate of dissolution to be filed with the secretary of the state.¹¹⁵
- Dissolution can also take place if all the stockholders are entitled to vote to give written consent to such dissolution.¹¹⁶

¹⁰⁸ Ibid s. 182 (b)

¹⁰⁹ Ibid (2) (3)

¹¹⁰ Ibid (5)

¹¹¹ Ibid (4)

¹¹² Delaware Corporation Law s.182 (c) (1) (b) & (d); 182 (d) (b) & (d)

¹¹³ Delaware General Corporation Law

¹¹⁴ Ibid s. 275 (a)

¹¹⁵ Delaware General Corporate Law s. 275 (b) & (c)

¹¹⁶ Delaware General Corporate Law s. 275 (e)

- On the certificate of dissolution becoming effective the company shall stand dissolved.¹¹⁷

CASE LAWS

- In *The Chemours Company v. DowDuPont Inc., Corteva, Inc., and E.I. Du Pont de Nemours and Company*, C.A. No. 2019-0351, (Del. Ch.) March 30, 2020, the Court of Chancery recognized the use of parent-subsidary relationship by a parent company in the event of structuring a spin-off, dealing on an arms-length basis with its subsidiary will not apply to such transaction.
- In *Hollinger International, Inc. v. Black* 58 A.2d 342 (Del. Ch.), appeal denied, 871 A.2d 1128 (Del. 2004) the court of chancery in the light of section 271 rejected the argument that the vote of the stockholders is not needed to sell the assets of its wholly-owned non-Delaware subsidiary. In the context of this section, the court of chancery was willing to collapse the separation between a parent company and its subsidiary.¹¹⁸

CONCLUSION

Across all three jurisdictions, the understanding of the concept of a group company is almost identical. There is a common consensus that a group company is nothing more than a large enterprise comprising of various other company structures and all of them work under the common management and supervision of the group company. The Companies Act, 2013 is to a large extent inspired by UK's Company Act, 2006. Both these legislations are largely exhaustive and prescriptive. While the Delaware General Corporate Law is not as extensive, it allows for greater flexibility to companies incorporated under this act. A company or legal advisor before taking any such decision under the DGCL will largely have to depend on the plethora of precedents set by the Court of Chancery. This may be a tedious process for the company and its legal advisors, although it gives a clearer picture of the real-time effect of a given legal problem.

This being said the Indian and UK legal systems can greatly benefit from adopting some amount of flexibility as reflected in the DGCL, after all, most fortune five hundred companies

¹¹⁷ Delaware General Corporate Law s. 275 (f)

¹¹⁸ Mark A. Morton, Michael K. Reilly, 'Clarity or Confusion: The 2005 Amendment to Section 271 of the Delaware General Corporation Law' <<https://www.potteranderson.com/newsroom-publications-149.html>> (1 November 2005) Accessed on 16 December 2021

around the world are incorporated in Delaware. Such comparison of legal concepts across various jurisdictions helps us better understand them and helps fill lacunas existing in a certain legal system.

