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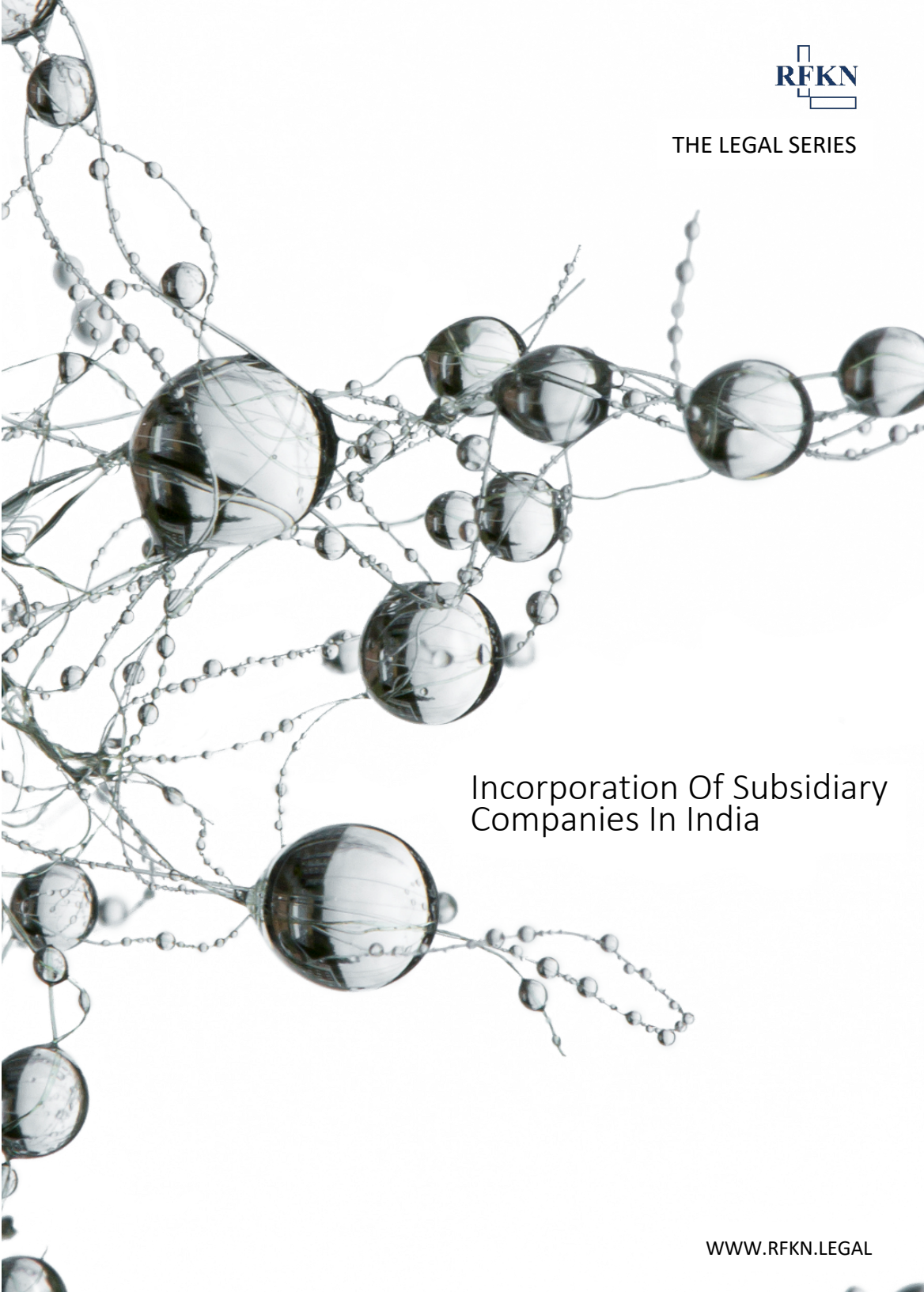

Incorporation Of Subsidiary Companies In India

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INCORPORATION OF SUBSIDIARY COMPANIES IN INDIA

UNDERSTANDING THE INDIAN FRAMEWORK

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INCORPORATION OF SUBSIDIARY COMPANIES IN INDIA

I. Introduction

The incorporation of subsidiary companies in India whether by foreign multinationals or domestic parent entities follows the framework laid down under the Companies Act, 2013, alongside allied regulations under the Foreign Exchange Management Act (FEMA), 1999, and sector-specific guidelines issued by the Reserve Bank of India (RBI) and the Department for Promotion of Industry and Internal Trade (DPIIT). A subsidiary company, as defined under Section 2(87) of the Companies Act, is one in which the holding company either controls the composition of the board of directors or holds more than half of the total share capital, including equity and convertible preference shares.

II. Companies Act and FEMA

The procedural route to setting up a subsidiary depends on whether the parent company is Indian or foreign. Indian companies incorporating domestic subsidiaries are governed solely by the Companies Act and must comply with procedural norms including incorporation under Section 3, allotment of shares, appointment of directors under Sections 152 and 161, and maintaining statutory

registers. Where a subsidiary is incorporated as a private limited company, additional exemptions under Section 2(68) may apply, particularly in relation to public disclosures, filing obligations, and board structure.

For foreign companies establishing subsidiaries in India, additional regulatory layers apply. FEMA permits foreign direct investment (FDI) into Indian companies through either the automatic route or the government approval route, depending on the sector. This is governed by the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019. Under Rule 6, foreign investment is permitted subject to sectoral caps and conditions listed in Schedule I of the Rules. Companies must file Form FC-GPR (for fresh equity infusion) and ensure compliance with pricing guidelines and downstream investment norms, particularly if the subsidiary proposes to invest further in other Indian entities.

Where a foreign entity incorporates a wholly owned subsidiary, it must comply with Sections 379 to 393 of the Companies Act, 2013, read with the Companies (Registration of Foreign Companies) Rules, 2014. Section 379(2) stipulates that foreign companies having at least fifty percent of their shareholding held by Indian citizens or companies are also deemed to be Indian companies for compliance

purposes. Practically, this has implications for filings, audit, and corporate governance. Subsidiaries are not subject to Section 384's provisions on financial statement filings applicable to branch offices yet are treated as Indian companies once incorporated.

The procedural steps involve applying for name approval through the RUN (Reserve Unique Name) service on the MCA portal, drafting a Memorandum and Articles of Association in compliance with Schedule I of the Companies Act, appointing a minimum of two directors (one of whom must be an Indian resident), and filing incorporation forms (SPICe+ Part A and B, e-MOA, e-AOA, AGILE-PRO) with requisite documents and declarations. For foreign promoters, notarised and apostilled charter documents must be submitted, and a local Indian address must be furnished for the registered office.

III. Taxation Laws

Taxation laws further impact the structuring of subsidiaries. Indian subsidiaries are treated as resident companies under Section 6(3) of the Income Tax Act, 1961 and taxed on global income. Transfer pricing provisions under Sections 92 to 92F apply to transactions between parent and subsidiary companies, and the Place of Effective Management (POEM) test first introduced in Finance Act,

2015 and codified under CBDT Circular No. 6/2017 becomes relevant in determining whether management and control of the company lie in India. The POEM test is crucial in ascertaining whether a foreign-incorporated subsidiary could be taxed as an Indian resident based on factual control.

IV. Sector-Specific Regulations

Apart from corporate and tax law, sector-specific laws also influence the incorporation and operation of subsidiaries. For example, in the insurance sector, foreign equity in Indian insurance companies is capped under the Insurance Act, 1938 (as amended) and monitored by the Insurance Regulatory and Development Authority of India (IRDAI). Similarly, banking subsidiaries must comply with RBI guidelines issued under the Banking Regulation Act, 1949, and subsidiaries operating in the telecom or defence sectors require security clearances and prior government approval.

Finally, incorporation is not the end of regulatory scrutiny. The Companies (Significant Beneficial Owners) Rules, 2018 and the Prevention of Money Laundering Act, 2002 require disclosure of the ultimate beneficial owners behind layered or indirect control, including in foreign-held subsidiaries. This reflects a growing emphasis on transparency in corporate structures and limits the use

of subsidiaries as opaque holding mechanisms.

V. Significant Judgments

The Indian judiciary has approached the question of whether a subsidiary functions independently or as an extension of its parent with evolving nuance all while reiterating the principle of corporate separateness, courts have not hesitated to lift the veil where economic realities demand it.

A foundational reaffirmation of corporate autonomy appears in ***Vodafone International Holdings BV v. Union of India***[1]. The Supreme Court emphasised that the mere fact that a parent company owns the entire shareholding of a subsidiary does not by itself erode the latter's separate legal status. The assets of a subsidiary do not automatically become the assets of the parent unless the subsidiary is functioning as an agent. Vodafone's acquisition of CGP Investments in the Cayman Islands, which indirectly held a controlling interest in an Indian telecom company, was scrutinised for tax liability. However, the Court concluded that the transaction reflected a legitimate investment structure, not a tax-avoidance device. The decision turned on six factors such as

[1] (2012) 6 SCC 613

business continuity, duration of holding structure, and revenue generation in India which helped distinguish lawful structuring from sham arrangements.

That said, Indian jurisprudence does not confer blanket immunity on layered corporate setups. In ***Life Insurance Corporation of India v. Escorts Ltd.,***[2] the Court had already acknowledged that the veil may be lifted for specific statutory purposes. The case involved investments by thirteen companies belonging to the Caparo Group under the FERA regime. Critics alleged an attempt to sidestep the 1% investment cap per non-resident entity. The Court clarified that although the identity of shareholders overlapped, each investing company was a distinct legal person. However, to determine eligibility under FERA, a limited lifting of the veil was permissible specifically to ascertain nationality and beneficial ownership, not individual identity or intent. The ruling thus struck a careful balance, it preserved corporate identity while allowing the State to verify compliance with regulatory thresholds.

The veil has been more readily lifted in cases involving misuse of subsidiary structures for regulatory evasion or commercial fraud. In

[2] 1986 (1) SCC 264

State of Rajasthan v. Gotan Lime Stone Khanij Udyog (P) Ltd.[3], a partnership converted into a private company, which then sold all its shares to a subsidiary of UltraTech Cement. Although each individual step was facially legal, the composite transaction amounted to an indirect transfer of a mining lease, circumventing required State approvals. The Court found this restructuring to be a ruse, undertaken to do indirectly what was impermissible directly. It emphasised that public interest considerations warranted piercing the corporate veil, especially when State-controlled resources were involved.

A more benign instance of veil-lifting arose in ***State of U.P. v. Renusagar Power Co***.[4], where Hindalco's wholly owned subsidiary supplied it electricity. The Court held that the two entities were so tightly integrated in function and control that the subsidiary's operations could be deemed those of the parent. This enabled Hindalco to benefit from a lower duty under the Electricity Act, treating the power supply as internally generated. The judgment showcases that disregarding corporate separateness is not always punitive, it may also facilitate the application of beneficial provisions

[3] (2016) 4 SCC 469
[4] (1988) 4 SCC 59

where economic substance overrides legal form.

In contrast, in ***Balwant Rai Saluja v. Air India Ltd.***,[5] the Court drew a sharper line. Although Air India exercised financial and managerial control over its subsidiary Hotel Corporation of India (HCI), this did not suffice to render HCI's employees as Air India's. The Court characterised the relationship as supervisory rather than commanding, and emphasised that parent-subsidiary connections, even when close, do not automatically translate into legal unity. The veil would only be lifted where the subsidiary is fully subordinate or created for a fraudulent purpose.

In ***Globe Ground (India) Employees Union v. Lufthansa German Airlines***[6], the Supreme Court was faced with a dispute involving Lufthansa and its wholly owned Indian subsidiary, Globe Ground India. The issue centred on whether Lufthansa could be held liable as a principal employer for statutory dues owed to employees of the subsidiary. The Court reaffirmed the principle that a parent and its subsidiary are distinct legal entities and rejected the argument that Lufthansa had functional or supervisory control that would justify piercing the corporate veil. The fact that Lufthansa had shareholding

[5] 2011 SCC OnLine Del 2030
[6] (2019) 15 SCC 273

and board representation was not enough to establish employer-employee relationship. Instead, the Court emphasised that to disregard the corporate form, there must be overwhelming evidence that the subsidiary is a mere façade, or that the parent exercised such deep and pervasive control that the two entities are indistinguishable. This judgment builds on Balwant Rai Saluja and Vodafone, reinforcing a narrow reading of veil lifting in commercial contexts. It is significant because it tempers the tendency to treat foreign parents as de facto employers or controllers simply due to ownership or board presence, thereby safeguarding legitimate subsidiary structures in India from undue attribution of liability.

VI. Conclusion

Collectively these decisions outline the boundaries of lawful structuring and underscore the judiciary's growing reliance on substance-over-form reasoning. While corporate personality remains a core tenet of Indian company law, its sanctity yields when regulatory evasion, public interest, or tax avoidance are credibly established. In the context of subsidiary incorporation whether by foreign MNCs or domestic firms, the law thus rests on a contextual, fact-sensitive inquiry: when is a subsidiary truly autonomous, and when is it a shell?