<u>COMPANIES TO HAVE TWO LAYERS OF SUBSIDIARIES, SAY NEW COMPANIES RULES AS NOTIFIED BY THE MINISTRY OF CORPORATE AFFAIRS.</u>

New Companies rules notified [G.S.R. 1176(E) F. No. 01/13/2013 CL-V (Vol.III) Dt. 20th September 2017] by Ministry of Corporate Affairs now require that corporates can have only two layers of subsidiaries under the companies' law, with the government putting in place stricter norms as it continues with the clampdown on illicit fund flows.

Banking companies, non-banking financial companies, insurance firms and government companies have been exempted from the restrictions, according to aforesaid notification issued by the corporate affairs ministry. "...for computing the number of layers under this rule, one layer which consists of one or more wholly-owned subsidiary or subsidiaries shall not be taken into account," it said.

Additionally, the restriction will not prohibit an Indian company from acquiring a foreign company that has more than two layers of subsidiaries. Though existing structures – where more than two layers of subsidiaries exist – have been grandfathered, such companies are prohibited from creating additional layers and have to disclose the number of layers beyond two to Registrar of Companies within 150 days.

The new rules paint all companies with the same brush. The assumption is that anyone who has more than two-layers of subsidiaries is doing something wrong. The exceptions to the rule may also defeat the purpose of the rule.

In case of violation of the norms, the company as well as every officer of that firm who is in default would face penalties. The fine would be up to Rs 10,000 and in case of repeated violation, the penalty "may extend to Rs 1,000 for every day after the first during which such contravention continues". Layering restriction on investment subsidiaries were incorporated in the Companies Act, 2013 with a view to check misuse of multiple layers of subsidiaries for diversion of funds/siphoning off funds as a measure of minority investor protection.

The decision to impose a limit on number of investment subsidiaries was taken by the Ministry of Corporate Affairs ("MCA") in the wake of the Purti scam, which exposed the lacunae existing in the Indian corporate regime. This restriction is set to significantly affect a variety of corporate transactions in India, especially with respect to companies that operate across multiple sectors with an investment company at the top; a structure common in the real estate and infrastructure sectors. However, since the Companies Act, 2013 seems to restrict investment through more than 2 layers of investment companies, it may still be possible to structure investments through companies other than investment companies.