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## The Doctrine of 'Alter Ego': When Can a Holding Company be Held Liable for the Acts of its Subsidiary?

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### **INTRODUCTION :**

In contemporary corporate law, the concept of holding companies and its subsidiaries and the doctrine of 'alter ego' holds a pivotal significance, as it serves as a critical mechanism for piercing the corporate veil and holds the holding companies liable for the action of their subsidiaries. But when does this doctrine come into play, under what circumstances can a holding company be held accountable for the acts of its subsidiary? Let's delve into the nuances of this legal doctrine to understand its implications.

Under section 2(46) of the Companies Act 2013, a Holding Company is defined as a company that controls the composition of the Board of Directors of another company, known as its subsidiary, either directly or indirectly<sup>1</sup>. This section provides a legal framework for understanding the hierarchical relationship between holding companies and their subsidiaries, elucidating their roles and responsibilities within the corporate structure.

Section 2(87) of the Companies Act 2013 defines a subsidiary company as one in which the holding company controls the majority of voting rights or exercises significant influence over its management<sup>2</sup>. This section delineates the legal parameters within which the subsidiary company operates, highlighting their dependence on the holding company while maintaining a separate legal identity. Section 2(87) which also encompasses foreign companies, lays down two criteria for establishing a holding-subsidiary relationship between two companies. As per the provision, a company is deemed to be a subsidiary of another company if it satisfies either of the following conditions:

- A company in which the holding company controls the composition of the Board of Directors
- Exercises or controls more than one-half of the voting power.

<sup>1</sup> Companies Act, § 2(46), No. 18, Acts of Parliament, 2013.

<sup>2</sup> Companies Act, § 2(87), No. 18, Acts of Parliament, 2013.

### **Understanding the Doctrine of ‘Alter Ego’:**

The Doctrine of ‘Alter Ego’ is a legal principle that allows courts to disregard the separate legal personality of a corporation when it is used as a mere instrumentality or alter ego of its shareholders or another corporation<sup>3</sup>. The doctrine helps in examining its implications on piercing the corporate veil and imposing liability on individuals or entities behind the corporate façade.

### **When the holding company is liable :**

The Companies Act 2013 in India has recognised subsidiary companies as a separate legal entity<sup>4</sup>. Piercing the corporate veil is a concept that is closely intertwined with the doctrine of ‘alter ego’. There must be compelling evidence to demonstrate that the subsidiary company is being operated as an alter ego of the holding company, rather than as a separate legal entity.

Placing reliance on the case of *Smith, Stone & Knight Ltd v Birmingham Corp.*<sup>5</sup> the learned judge referred to six points which are useful for ascertaining who really was carrying on the business<sup>6</sup>.

- Firstly, were the profits treated as the profits of the parent company? · Secondly, were the persons conducting the business appointed by the parent company?
- Thirdly, was the parent company the head and the brain of the trading company? · Fourthly, did the parent company govern the adventure, decide what should be done and what capital should be embarked on the venture?
- Fifthly, did the subsidiary company make the profits by its skill and direction? · Lastly, was the parent company in constant and effectual control of the subsidiary company?

So, therefore the crux of the matter lies in understanding the nature and extent of control exerted by a holding company over its subsidiary, determining the threshold at which the holding company becomes liable for the actions of its subsidiaries. The holding company and

<sup>3</sup> Sunil Bharti Mittal v Central Bureau of Investigation, AIR 2015 SC 923

<sup>4</sup> Vodafone International Holdings B.V v Union Of India & Anr

<sup>5</sup> Smith, Stone & Knight Ltd v Birmingham Corp, (1939) 4 All ER 116(KB).

<sup>6</sup> Avtar Singh, Company Law, 25, EBC.

its subsidiary cannot assert the defence of being separate legal entities in the following instances:

- Excessive degree of control by the holding company over the subsidiary<sup>7</sup>.
- The company is merely a cloak or sham<sup>8</sup>.

· The two companies are inextricably inter-linked corporate entities<sup>9</sup>.

### **Conclusion:**

The doctrine of 'alter ego' serves as a cornerstone of corporate law, allowing courts to hold holding companies accountable for the actions of their subsidiaries under certain circumstances. By piercing the corporate veil and disregarding the separate legal identity of the subsidiary, courts can ensure that justice is served and that corporate entities are held responsible for their conduct. However, the application of the doctrine requires careful consideration of the facts and circumstances of each case to strike a balance between corporate autonomy and accountability. As corporate structure continues to evolve the doctrine of 'alter ego' will remain a vital tool for upholding the principles of fairness and transparency within the corporate realm.

<sup>7</sup> Vodafone International Holdings BV v Union of India, (2012) 6 SCC 613

<sup>8</sup> Bhatia Industries & Infrastructure Ltd. v Asian Natural Resources (India) Ltd., 2016 SCC OnLine Bom 10695 <sup>9</sup> State of U.P. v. Renuagar Power Co., (1988) 4 SCC 59