

Why an LLP is a Subsidiary on Your Balance Sheet, But Not in the Boardroom

Consider the humble tomato. If you ask a botanist, they will confidently tell you it is a fruit because it contains seeds and develops from the ovary of a flower. But if you ask a chef, they will chop it up, toss it into a savoury stew, and firmly declare it a vegetable. The exact same object is classified in two completely different ways depending on the rulebook you are using.

This article delves into a strikingly similar corporate conundrum: Can a Limited Liability Partnership (LLP) be legally considered a subsidiary of a company? To answer this, we will explore the differing interpretations between the principle-based lens of the Indian Accounting Standards (Ind AS) and the strict, rule-based framework of the Companies Act, 2013. Ultimately, we will uncover why an LLP acts as a subsidiary for your financial ledgers but sheds that title when navigating statutory corporate compliances.

The Accountant's Lens: The Substance Over Form

When preparing financial statements, the law relies on accounting standards to ensure transparency and economic reality. Section 133 of the Companies Act empowers the Central Government to prescribe these standards. If we look through the lens of the Companies (Indian Accounting Standards) Rules, 2015 and the Companies (Accounting Standards) Rules, 2021, the definition of a subsidiary is broad and inclusive.

Under these standards, specifically **AS-21**, **Ind AS-110**, and **Ind AS-24** the focus is on the *concept* of control rather than corporate structure.

- **Ind AS-110** defines a subsidiary as an entity controlled by another, where control means having the right to variable returns and the ability to affect those returns through power over the investee.
- Because an LLP agreement can grant specific management rights and control over variable returns to a corporate partner, that company exercises "control" under Ind AS-110.

- Consequently, for the purposes of consolidating financial statements, an LLP is absolutely considered a subsidiary of the controlling company.

The Legislator's Lens: The Strict Boundaries of the Act

However, when we step out of the accounting ledgers and into the strict statutory compliance of the Companies Act, 2013, the rules of the game change. Section 2(87) of the Act provides a highly restrictive, rule-based definition of a "subsidiary".

For a company to hold another entity as a subsidiary under Section 2(87), it must satisfy at least one of two mandatory conditions:

1. **Control over the composition of the Board of Directors:** The Companies Act operates on the premise of Directors, Shareholders, and General Meetings. An LLP, governed by the LLP Act, 2008, is a body corporate that recognizes "partners" and "designated partners," not directors. Because the basic structural roles are not legally comparable, a company cannot fulfil the condition of controlling a non-existent Board of Directors in an LLP.
2. **Control over more than one-half of the total voting power:** In a traditional company, voting power is proportionate to paid-up share capital. In an LLP, voting rights are dictated entirely by the mutual LLP agreement and have no inherent statutory connection to the capital contribution made. Furthermore, LLPs do not operate on the concepts of Ordinary or Special Resolutions. Thus, the concept of holding statutory "voting power" fails to apply.

Because neither strict parameter can be met, an LLP cannot be considered a subsidiary under the Companies Act, 2013.

When the Boundary Rope Matters: Statutory Implications

Just as a boundary rope in cricket fundamentally changes the value of a shot, this strict legal interpretation drastically alters how a company interacts with an LLP it practically controls. If the LLP is not a subsidiary under the Act, several restrictive sections no longer apply:

- **Section 19(1):** This section prohibits a subsidiary from holding shares in its holding company. Because the controlled LLP is not legally a subsidiary, it is not prohibited from holding shares in the controlling company.

The Danger of Re-writing Rules: Casus Omissus

One might argue: *If a company clearly controls an LLP, shouldn't we just interpret the law broadly to include it, preventing governance loopholes?*

The legal principle of *Casus Omissus* (a situation omitted from a statute) dictates that a court cannot simply supply words or concepts that the legislature deliberately left out.

This boundary was explicitly enforced by the NCLAT order of *Regional Director, Southern Region v. Real Image LLP* regarding the amalgamation of an LLP into a company under Sections 230 to 232 of the Companies Act. The tribunal denied the merger, noting that while the Act explicitly allows foreign bodies corporate to merge into Indian companies, it provides no such framework for domestic LLPs. The tribunal held that the principle of *casus omissus* cannot be applied to forcefully bridge that statutory gap. Similarly, we cannot forcefully read "LLP" into the strict confines of Section 2(87). The law must be applied exactly as it is written, not as it might be convenient.

Conclusion

In the end, corporate governance demands that we play strictly by the rules laid out before us. As per Rule 6 of the Companies (Accounts) Rules, 2014, a company must honour the economic reality and consolidate the financials of a controlled LLP as if it were a subsidiary.

However, under the strict, rule-based perimeter of Section 2(87) of the Companies Act, 2013, that same LLP cannot be treated as a subsidiary. This dual identity may create friction in regulatory compliance, and there is a pressing need for lawmakers to harmonize Section 2(87) with Ind AS-110 to prevent absurdities. But until the legislature changes the text, the boundary remains fixed. Just like our tomato, a fruit in the garden and a vegetable in the kitchen the LLP remains a subsidiary for the accountants, but a separate, non-subsidiary entity in the eyes of the law.