Partially owned subsidiary

Overview All of these terms are used to describe situations where one company owns part or all of another company. More terms Company B & C are also called Daughter Companies of Company A (the Parent Company) Company B is a Sister Company to Company C, and vice-versa Company A, B & C are Affiliate Companies of Company D, and vice-versa Ownership of 50% or more= Subsidiary A subsidiary is a company where at least 50% of its shares are owned by another company. Subsidiaries can be wholly-owned or partly-owned. Wholly-owned: 100% of the subsidiary's shares are owned by the parent company. The parent company has complete control over the subsidiary. Partly (or partially)-owned: the parent company owns at least 50% but less than 100% of the subsidiary's shares. The parent company doesn't have complete control, but it should have a controlling interest. Controlling Interest A shareholder with a controlling interest has significant influence over the actions of the company. What is interesting is that it isn't enough that there is a 50%+ number; the Company has to have the right to make/ ability to prevail in major decisions regarding the held company. Consider the following example. Suppose your company enters into a deal with another company—we will call them Other Company, because I'm feeling super creative today— to establish a new company together. The name of that company is New Company (you see? I'm on fire!). You explain to Other Company that it's really important to you that New Company be a subsidiary. (We can discuss why you might want this at another time). Other Company is cool with that. They suggest that the two of you divide up New Company like this: 51% voting rights > 50% of shares = subsidiary! You sign and New Company is established. At year-end you are chatting with your accountant and you tell them "Accountant! We have a new subsidiary this year!" Your accountant looks over the chart you made them (above—excellent job by the way) and over the contracts between Your Company and Other Company and tells you that you don't have a subsidiary. Instead you have an equity investment. But you have over 51% of the voting rights! Yes, but you still don't have a controlling interest. Control is more than a number. What Accountant saw is that while you have 51% voting rights, in this case, that doesn't really amount to much. Both companies are entitled to the same portion of profits and losses. Both companies have the same number of Board members. And when Accountant went in and read the endless agreements that Your Company and Other Company signed off on, she discovered that there are all sorts of clauses that require that most major decisions and transactions require unanimous consent by the Board. The 51% isn't fictitious, but it also isn't a controlling interest. There are other factors which could impact the percentage shares required to have a controlling interest, such as regulations in the jurisdiction where the company was established or agreements between the shareholders. Ownership of less than 50% = Equity Investment An equity investment is when a company owns a portion of the shares of another company, but less than 50%. While the company may certainly have influence, and possibly even a lot of say into how the other company is run, it is not a controlling influence. © 2020 Defmacro Software Pvt. Ltd. ClearTax offers taxation & financial solutions to individuals, businesses, organizations & chartered accountants in India. ClearTax serves 1.5+ Million happy customers, 20000+ CAs & tax experts & 10000+ businesses across India. Efiling Income Tax Returns(ITR) is made easy with ClearTax platform. Just upload your form 16, claim your deductions and get your acknowledgment number online. You can efile income tax return on your income from salary, house property, capital gains, business & profession and income from other sources. Further you can also file TDS returns, generate Form-16, use our Tax Calculator software, claim HRA, check refund status and generate rent receipts for Income Tax Filing. CAs, experts and businesses can get GST ready with ClearTax GST software & certification course. Our GST Software helps CAs, tax experts & business to manage returns & invoices in an easy manner. Our Goods & Services Tax course includes tutorial videos, guides and expert assistance to help you in mastering Goods and Services Tax. ClearTax can also help you in getting your business registered for Goods & Services Tax Law. Save taxes with ClearTax by investing in tax saving mutual funds (ELSS) online. Our experts suggest the best funds and you can get high returns by investing directly or through SIP. Download ClearTax App to file returns from your mobile phone. A subsidiary (sub) is a business entity or corporationOtherArticles covering other finance topics ranging from Warren Buffett to hedge fund strategies. These other finance topics are an interesting read that is fully owned or partially controlled by another company, termed as the parent, or holding, company. Ownership is determined by the percentage of shares held by the parent company, and that ownership stake must be at least 51%.What are the Attributes of a Subsidiary?A subsidiary operates as a separate and distinct corporationCorporationA corporation is a legal entity created by individuals, stockholders, or shareholders, with the purpose of operating for profit. Corporations are allowed to enter into contracts, sue and be sued, own assets, remit federal and state taxes, and borrow money from financial institutions. from its parent company. This benefits the company for the purposes of taxation, regulation, and liability. The sub can sue and be sued separately from its parent. Its obligations are also typically its own and are not usually a liability of the parent company.The minimum level of ownership of 51% guarantees the parent company the necessary votes to configure the subsidiary's board. This allows the parent to exercise control in company decision-making.Parents and sub-companies need not operate in the same location, nor be in the same line of business. Subsidiaries may also have their own sub-companies; the line of succession forms a corporate group with varying degrees of ownership.Advantages#1 Tax benefitsA parent company can substantially reduce tax liability through deductions allowed by the state. For parent companies with multiple subsidiaries, the income liability from gains made by one sub can often be offset by losses in another.#2 Risk reductionThe parent-subsidiary framework mitigates risk because it creates a separation of legal entities. Losses incurred by a subsidiary do not readily transfer to the parent. In case of bankruptcy, however, the subsidiary's obligations may be assigned to the parent if it can be proven that the parent and subsidiary are legally or effectively one and the same.#3 Increased efficiencies and diversificationIn some cases, creating subsidiary silos enables the parent company to achieve greater operational efficiency, by splitting a large company into smaller, more easily manageable companies.Disadvantages#1 Limited controlA parent may have management control issues with its subsidiary if the sub is partly owned by other entities. Decision-making may also become somewhat tedious since issues must be decided through the chain of command within the parent bureaucracy before action can be taken.#2 Legal costsLengthy and costly legal paperwork burdens result, both from the formation of a subsidiary company and in filing taxes.Example of a Subsidiary StructureOne popular parent company in the digital industry is Facebook. Aside from being publicly traded on the open market, it also has multiple investment portfolios in other companies within the social media industry and is the parent firm of several software technology sub-companies.Examples of Facebook sub-companies are:Instagram, LLC – a photo-sharing site acquired by Facebook in April 2012 for approximately US$1B in cash and stock. Instagram remains separate in its operational management, being led by Kevin Systrom as CEO.WhatsApp Inc. – Facebook acquired this popular messaging application for roughly US$19.3B in 2014.Oculus VR, LLC – In March 2014, Facebook agreed to buy shares, worth $2B, of virtual reality company, Oculus.Learn more about Facebook's corporate structure -> resourcesThank you for reading this guide to sub-companies and the various pros and cons of this type of corporate hierarchy. CFI's mission is to help you become the best financial analyst possible. With that goal in mind, these additional CFI resources can help you on your way:BankruptcyBankruptcyBankruptcy is the legal status of a human or a non-human entity (a firm or a government agency) that is unable to repay its outstanding debtsPublic company filingsPublic FilingsFind public company filings. CFI has organized all the main sources of public company filings such as 10-K, 10-Q, S-1,13D, EDGAR, SEDAR, and other databases. These sources are vital for financial analysts performing financial modeling and valuation work.Tax havensTax HavenA tax haven or offshore financial center is any country or jurisdiction that offers minimal tax liability to foreign individuals and businesses.What is financial modeling?What is Financial ModelingFinancial modeling is performed in Excel to forecast a company's financial performance. Overview of what is financial modeling, how & why to build a model. When the amount of stock owned is >50% of common stock, a parent-subsidiary relationship is formed that requires consolidated reporting. Explain how to report for a combined entity Key Takeaways Key Points A subsidiary company, or daughter company is a company that is completely or partly owned and partly or wholly controlled by another company that owns more than half of the subsidiary's stock. Consolidated financial statements show the parent and subsidiary as one single entity. During the year, the parent company uses the equity method to account for its investment. At the end of the year, a consolidation working paper eliminates intercompany transactions between parent and subsidiary. As of 2004, the acquisition method is the only allowable method that can be used to prepare consolidated financial statements for companies that combined after 2004. Other consolidation methods previously used were the purchase and the pooling of interests methods. Key Terms state-owned enterprise: A government-owned corporation, state-owned company, state-owned entity, state enterprise, publicly owned corporation, government business enterprise, commercial government agency,public sector undertaking or parastatal is a legal entity created by a government to undertake commercial activities on behalf of an owner government. The ownership of more than 50% of voting stock creates a subsidiary. The financial statements of the parent and subsidiary are consolidated for reporting purposes. A subsidiary company, or daughter company is a company that is completely or partly owned and partly or wholly controlled by another company that owns more than half of the subsidiary's stock. The subsidiary can be a company, corporation, or limited liability company. In some cases it is a government or state-owned enterprise. The controlling entity is called its parent company, parent, or holding company. An operating subsidiary is a business term frequently used within the United States's railroad industry. In the case of a railroad, it refers to a company that is a subsidiary but operates with its own identity, locomotives, and rolling stock. In contrast, a non-operating subsidiary would exist on paper only (i.e. stocks, bonds, articles of incorporation) and would use the identity and rolling stock of the parent company. When the amount of stock purchased is more than 50% of the outstanding common stock, the purchasing company usually has control over the acquired company. Control in this context is defined as ability to direct policies and management. In this type of relationship the controlling company is the parent and the controlled company is the subsidiary. The parent company needs to issue consolidated financial statements at the end of the year to reflect this relationship. Consolidated financial statements show the parent and the subsidiary as one single entity. During the year, the parent company can use the equity or the cost method to account for its investment in the subsidiary. Each company keeps separate books. However, at the end of the year, a consolidation working paper is prepared to combine the separate balances and to eliminate the intercompany transactions between the parent and the subsidiary, along with the subsidiary's stockholder equity and the parent's subsidiary investment account. The result is one set of financial statements that reflect the financial results of the consolidated entity. As of 2004, the acquisition method is the only allowable method that can be used to prepare consolidated financial statements for companies that combined after 2004. Other consolidation methods previously used were the purchase and the pooling of interests methods. The following is an example of how to calculate consolidated net income — assume ABC Corporation owns 80% of XYZ Corporation; the remaining 20% is a non-controlling ownership interest. Net Income for 201X for ABC is USD 20,000 and for XYZ net income is USD 8,000. First, to arrive at consolidated net income for the two companies, ABC must eliminate the effect of the equity method used to account for its investment. ABC's net income for the year includes 80% of XYZ's net income, or USD 6,400. This amount must be subtracted from the net income figure to arrive at 13,600 (20,000 – 6,400). The consolidated net income for both companies after this adjustment is USD 21,600 (20,000 – 6,400 + XYZ's total net income of 8,000). Second, the portion of net income attributed to the non-controlling ownership interest must be deducted, or USD 1,600 (8,000 *.20). Therefore, consolidated income for ABC and its controlling interest in XYZ is USD 20,000 (21,600 – 1,600). A subsidiary company is a business entity that is fully or partly owned by another entity. If an X company buys Y company, Y becomes the subsidiary company of X. The company that buys another company becomes a holding company. Hence, it holds significant ownership & control over the subsidiary company. The holding company is also called the parent company & the subsidiary company is also called the daughter company. It shows the relationship that the subsidiaries belong to the holding company. Partly OwnedThe parent company owns 50% or more but less than 100% shares in the holding company. Such a subsidiary is partly owned. Here parent company does not get full control over the subsidiary company.Wholly OwnedThe parent company holds 100% shares & controls in the subsidiary company. Though, A wholly-owned subsidiary company is not a merger.Points to remember When the parent company holds less than 50% shares in any company, it is called an affiliate company. A holding company can have more than one subsidiary company. But a subsidiary company can have one and only one holding company. However, a subsidiary can have a subsidiary or more of its own. The parent company can be larger or smaller than the subsidiary. It need not be more powerful than the subsidiary. The size of the firm or employees does not decide the relationship. The only control over ownership is the key factor. Also, the location or type of business of both companies does not matter. They may or may not be in the same location or same business line. FormationThe parent company has to register with the state registrar of the state in which the company operates. The ownership & stake details are to be defined during this process. OperationNormally, the parent company just oversees the operations of the subsidiary company. However, in certain cases, the parent company may supervise day to day operations of a subsidiary company.Subsidiaries are separate legal entities. They have their own concerns regarding the handling of taxation, regulations & liabilities. Subsidiary companies can sue & be sued separate from the parent company. the obligations of a subsidiary may or may not be obligations of the parent company. One of these companies can be undergoing legal proceedings, bankruptcy, tax delinquency or be under investigation without affecting other companies directly. though affecting public image is altogether an intangible thing. Hence, forming a subsidiary protects the assets from each other's liabilities.The copyrights, patents, trademarks etc of a subsidiary company stay with them until the parent shuts it down.Since holding company controls the subsidiary through ownership of shares, it gets voting rights to determine the board of directors.Accounting & FinancialsSubsidiaries being an independent identity and they prepare their own financial statements. They have their own bank accounts, assets, liabilities, etc. All the transactions between the parent company and subsidiary company are to be recorded. Further, these statements are sent to the parent company.The parent company aggregates and consolidates subsidiary's transactions into its own books of accounts. According to the Securities & Exchange Commission (SEC), public companies should consolidate all majorly owned firms or subsidiaries to show true & fair value. The figures in profit and loss statement or balance sheet include values for both parent & subsidiary company. For example, aggregate sales, aggregate purchase, aggregated assets & liabilities. In contrast, a parent company does not consolidate accounts of the affiliated company. It registers the value of the stake in such an affiliate company as an asset in the balance sheet.In rare cases, the SEC allows this option. That is to say, when a parent company does not hold a significant stake, a subsidiary company is undergoing bankruptcy, major liquidation crises, etc. The parent company does not include financials of the subsidiary companies in its statements. However, it shows ownership of such a company as an equity asset in the companies balance sheets. Facebook is a popular company in the digital industry. It has various subsidiaries acquired from time to time. Instagram is a photo-sharing application acquired by Facebook in April 2012. It also acquired Whatsapp – a popular messaging application in 2014. Lastly, in march 2014, It bought shares of a virtual reality company, Oculus. Google & Nest are subsidiaries of Alphabet. TCS – Tata consultancy services are of TATA Group. Jio belongs to the Reliance Group. Lenovo acquired Motorola. Image SourceAdvantagesContain & Limit LossesThe probable losses of a parent company can set off against the subsidiary companies' profits. The assets of subsidiaries can be used as a liability shield against financial losses.Risk ReductionThe risk and uncertainty of losses, issues & obligations are distributed between two companies. In the case of bankruptcy however if an advocate proves that the parent company and subsidiary company are one and the same, the parent co. may be held liable.Increases Efficiencies & DiversificationWhen the size of the company increases, it often indulges itself into related & unrelated diversification. Subsidiaries help to split the activities according to common groups into smaller companies. They become easily manageable. The employees there can give their complete focus on their respective product or service.Tax BenefitsSubsidiaries follow the laws of a country or state it is located in. It has its separate tax ID, pays its own taxes according to its type. This is irrespective of the location of parent company & related laws. Parent companies can intentionally open subsidiaries in areas where they receive tax benefits. For example, special economic zones or rural areas where the government gives certain deductions for operating business.Easy Establishment & SellingInnovations & experiments can be done through subsidiary companies. Different organizational structures, manufacturing techniques & types of products can be developed & put in the market. In case of failure, subsidiaries can be shut down without affecting the image of the parent company directly.SynergiesA company can open subsidiaries to support its activities. Subsidiaries can be a tool for horizontal or vertical integration.DisadvantagesLimited ControlThough the parent company has significant stake and voting rights in a subsidiary, it cannot control all the activities of the company directly. However, the wrong decision taken by such a company affects the image of a parent company.WorkloadAdhering to legal norms, accounting work, auditing accounts, etc. increase the workload of the employees.BureaucracyDecision making becomes a tedious task as it has to go through the various levels of the organization. Also, it gives an open window to malpractices & bureaucracy.ComplexityAggregation & consolidation of accounts makes it complex for any person to analyze the financial statements. For example, the value of sales, purchase, loss, profit etc show aggregate values, it is difficult to trace each value to its origin.Moreover, there are different rules and regulations as per accounting standards & taxation which determine the norms for the stake of parent company & liability. They differ from country to country. To understand all of them is a task in itself.Time & Cost ConsumingEmployees have to spend time in the preparation of accounts, sending it to the parent company, following the formalities & procedures.Burdensome Since subsidiaries are independent to a certain extent, they may have their own issues. The parent company cannot control everything that happens there. The parent company may become liable for criminal actions on a subsidiary in case corporate veil is proven.Share Knowledge if you liked