NOTE ON RELATED PARTY TRANSACTIONS

Pursuant to Section 297 of the Companies Act, 1956 Prior approval of Board of Directors and Central Government needed to enter into transactions with Related Parties.

 # Nature of Transactions:

a) Sale, Purchase or supply of any goods, materials or services or;
b) Underwriting the subscription of any shares in or debentures of, the Company.

However, nature of transactions are inclusive, it includes routine to rare supply of goods in either way of sale, purchase or supply of **any goods** or **Services** (technical support, maintenance, consultancy, advisory or sharing professional knowledge etc) and underwriting financial instruments of the Company, while entering into such type of transactions Company require to take prior approval of Board of Directors and Central Government as well.

 # Applicability of Section 297:

There are few grounds which differentiate Companies from taking Central Government approval and only the approval of Board of Directors is suffice. They are as follows;

a) Capital Clause:
   If paid up Capital of the Company is less than Rs. 1 Cr. – Only the approval from Board of Directors is required by passing an ordinary resolution in the meeting of Board of Directors approving such contract and value of the Contract.

   In case paid up Capital of the Company is equals or more than Rs. 1 Cr. – In addition to the approval from Board of Directors of the Companies, PRIOR approval of Central Government is required.

b) Exemptions, if any? :

   Yes, Section 297 under its Proviso (a), (b) & (C) of sub – section (2) provides for the Contracts which we could exclude from the purview of Commanding Section 297 (1); Exemptions are as follow:

   a) Purchase, sales, services & supply of any goods & material without applying Central Government for prior permission if the for entering into contract with any related party for cash at prevailing market price (cheque is equivalent to cash) (Note that only the Companies with capital less than Rs. 1 Cr. Can avail this benefit).

   b) Any contract between Related Parties is valid under this section provided that if the Value of the Transactions is less than or equal to Rupees Five Thousand only. (Capital clause is not applicable).
   c) Any contract between related parties is valid provided that, it must have happened in case of Banking or insurance Company and it should be in their ordinary course of business.

 # Applicability in case of Urgent Contracts:

In case, related parties enters into contracts for sale, purchase or supply of any goods, materials or services even if the value of such goods or cost of such services exceeds Rupees five thousand in the aggregate in any year comprised in the period of the Contract(s). But in such case, the consent of Board of Directors obtained at a meeting within three months of the date on which the contract was entered into. However, *Company having paid up Capital of Rupees one Crore or more is not eligible to avail the benefit of this provision.*

 # To Whom shall we Consider Related Party (ies):

a) Persons mentioned under section 297 of the Companies Act, 1956 *vis a vis:*
   - *i) Director of the Company or*
   - *ii) His relatives*
   - *iii) Firm in which such director or his relative is a partner*
   - *iv) Any other partner in such firm*
   - *v) A private company of which the Director is a member or Director &*
   - *vi) Nature Related Parties mentioned under Accounting Standard – 18*

   Definition of related party is again inclusive in nature; any type of connection between contracting parties or between key managerial persons of the Contracting parties will be held as Related Parties.

 # what if not complied with the provisions of the Companies Act, 1956:

a) Section 297 of the Companies Act, 1956 stays silent in case of non compliance with any of the provisions of Section 297.
b) Section 297 allied with its provisions is a **regulatory Section** and contravention or non compliance with provisions of this section falls into the list of the **offences** under the Companies Act, 1956. However, Company and every officer of the Company are held liable for such offence. The term "Officer" includes, Every Director of the Company (executive, non-executive, whole time, additional, alternate Director or any other), Company Secretary, Manager or any other person who is holding position of making decisions or controls the day to day affairs of the Company.

is there any way out?

While talking about way out to make good the offence done under section 297, we have to follow Section 621A & Section 629A.

a) About Section 621A:

Section 621A Provides opportunity to make the offence good by compounding of offence under section 297 by making application to the Central Government praying for make the offence good.

Under provisions of Section 621A offender can compound offences made for preceding three years. However, if the period of offence is more than three years then also offender have to make application for preceding last three years only, that will suffice.

Once the offence made good by compounding route, then offender cannot make application for compounding of offence for Next Three Years. That means, after Compounding of offence if person again contravenes any of the provisions of the Section in which he was found guilty and that was made good by Compounding of offence under section 621A of the "Act" then he cannot make an application to the Central Government for Compounding of offence under section 621A for the period of three years from the date of his last compounding.

b) About Section 629A:

Neither the Section 297 nor the Section 621A of the Companies Act, 1956 depicts about quantum or amount of penalty to be imposed to the offender. However, Section 297 defines about the limits and provisions, if any thereof. Accordingly, Section 621A provides for opportunity of compounding of offence and nature of penalty for the offences made under the Companies Act, 1956. But Section 629 A is the only section which talks about quantum or amount of penalty for the offences under the Companies Act, 1956 for which no penalty has been mentioned elsewhere in the act.

I) Penalties under section 629A:

If a Company or any other person contravenes any provision of this act, condition, limitation or restriction subject to which any approval, sanction, matter has been accorded, given or granted, the Company and every officer of the Company who is in default or such other person shall be punishable with fine;

i) which may extend to Rs. 5,000/- and

ii) Where the contravention is a **CONTINUING** one, with a further fine which may extend to **Rs. 500/- for EVERY DAY** after the first during which the contravention continues.

#what we are going to do?

1) **Step 1 :** We will pass a resolution in the meeting of Board of Directors;

a) For Compounding of Offence under Section 621A for the offence made under Section 297 by making an application to the Regional Director, Mumbai.

b) For taking prior permission to enter into Contract in next three year for approximate decided amount with each identified related party. (That means first of all we need to identify our related parties and most importantly quantum or value of contract we could possibly enter into with those Identified related parties within next three years.)

2) **Step 2:** Application to Regional Director, Mumbai;
   I) praying for Compounding of Offence under section 621A;
   II) Prior permission for entering into contract with identified related parties for next three years on estimated value under section 297.

After undergoing above exercise we will succeed in making good the offence made under section 297 during past period as well as we will get the prior permission of the Central Government for entering into contract with identified related parties for estimated value of the Contracts for next three years.

However, In future we can contract with related parties which are not mentioned herein above exercise but for that also we are suppose to take prior approval of Central Government at that point of time.

Accordingly, estimated contract values are not exact in nature, therefore, if contract value with any related party is expected to exceed the value of contract approved by Central Government then at that point of time we can again pray to Central Government to extend the value of contract with such related party.

#there is a formula for computing the penalty under section 629A:

No. Of days of violation of sec. 297 ***multiply*** no. Of Related Parties ***Multiply*** Company & no. Of officers of the Company ***Multiply*** Amount of penalty for continuing default of Rs. 500*/- for each day.

- *Amount of penalty of Rs. 500/- for every day after the first during which the contravention continues is at discretion of Regional Director i.e. Central Government. However, this may be less than prescribed amount but cannot exceed that amount.*

Regards,

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