

RELATED PARTY TRANSACTIONS UNDER THE COMPANIES ACT, 2013

Companies Act, 2013 has unveiled a new era in the Indian Corporate Sector which places more reliance on disclosure norms rather than on regulatory approvals. One such area is “related party transactions”. While the Companies Act, 1956 warranted approval of Central Government for related party transaction by large cap companies, Companies Act, 2013 calls for greater disclosures with members’ approval. The scope of transactions have also been widened to include transactions relating to immovable property also which were earlier left outside the ambit of Section 297 of the Companies Act, 1956.

Under the Companies Act, 2013, the whole concept of related party transactions has been capsulated in a single section, namely Section 188 which combines the erstwhile Sections 314 and 297 of the Companies Act, 1956 and also contains many new provisions within its scope. The section is deeply layered with many set of provisions and leaves the mind perplexed with its scope and coverage.

In this article, we have made an attempt to the analyse the concept of related party transactions under the Companies Act, 2013 as contained in Section 188 read with relevant rules made thereunder

Analysis of Section 188 of Companies Act, 2013 read with Rule 15 of Companies (Meetings of Board and its Powers) Rules, 2014

Section 188 is placed in “Chapter 12 – Meeting of Board and its Powers”. Section 188 requires a company to obtain approval of the Board and of the members, in certain situations, prior to entering of any transaction or agreement with a related party. An analysis of Section 188 requires understanding the following:

- ❖ Applicability of the Section
- ❖ Definition/Meaning of Related Party
- ❖ Transactions which are deemed as related party transactions
- ❖ Nature of approvals required
- ❖ Disclosure norms
- ❖ Exemptions/Non-applicability
- ❖ Consequences of non-compliance

We will proceed to understand the above provisions.

❖ Applicability of the Section

Section 188 is applicable to both private as well as public companies and is applicable with effect from 01.04.2014

❖ Definition/Meaning of Related Party

Section 2(76), read with rule 3 of Companies (Specification of definitions details) Rules, 2014, defines a related party as under:

“related party”, with reference to a company, means—

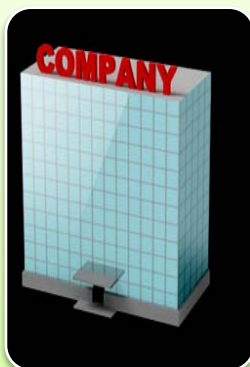
- *a director or his relative;*
- *a key managerial personnel or his relative;*
- *a firm, in which a director, manager or his relative is a partner;*
- *a private company in which a director or manager is a member or director;*
- *a public company in which a director or manager is a director or holds along with his relatives, more than 2% of its paid-up share capital;*
- *any body corporate whose Board of Directors, managing director or manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager;*
- *any person on whose advice, directions or instructions a director or manager is accustomed to act:*
Provided that nothing in sub-clauses (vi) and (vii) shall apply to the advice, directions or instructions given in a professional capacity;
- *any company which is—*
 - (A) *a holding, subsidiary or an associate company of such company; or*
 - (B) *a subsidiary of a holding company to which it is also a subsidiary;*
- *a director or key managerial personnel of the holding company or his relative*

COVERAGE OF “RELATED PARTY”



Individuals

- Director or his relative
- Key Managerial Personnel or his relative
- Any person on whose advice, directions or instructions a director or manager is accustomed to act
- A director or key managerial personnel of the holding company or his relative



Other than individuals

- A firm, in which a director, manager or his relative is a partner
- A private company in which a director or manager is a member or director
- A public company in which a director or manager is a director or holds along with his relatives, more than 2% of its paid-up share capital
- Any body corporate whose Board of Directors, managing director or manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager
- A holding, subsidiary or an associate company
- A subsidiary of a holding company to which it is also a subsidiary

❖ Transactions which are deemed as related party transactions

Any transaction between a company and its related party relating to:



Meaning of Office or place of profit for this purpose:

“office or place of profit” means any office or place—

- (i) where such office or place is held by a director, if the director holding it receives from the company anything by way of remuneration over and above the remuneration to which he is entitled as director, by way of salary, fee, commission, perquisites, any rent-free accommodation, or otherwise;*
- (ii) where such office or place is held by an individual other than a director or by any firm, private company or other body corporate, if the individual, firm, private company or body corporate holding it receives from the company anything by way of remuneration, salary, fee, commission, perquisites, any rent-free accommodation, or otherwise;*

❖ Exemptions/Non-applicability

The above mentioned provisions will not be applicable in case of transactions entered into by the company in its ordinary course of business, which are on arm's length basis.

“arm's length transaction” means a transaction between two related parties that is conducted as if they were unrelated, so that there is no conflict of interest.

❖ **Nature of approvals required**

• **Approval of Board of Directors**

- ✓ Every company needs to seek the approval of its Board of Directors for entering into any related party transaction, as listed above, irrespective of the capital of the company or the value of the transaction.
- ✓ Approval of the Board has to be sought at a duly convened meeting of the Board and same cannot be obtained by passing of a resolution by circulation.
- ✓ Where any director is interested in any contract or arrangement with a related party, such director shall participate in the Board Meeting in which the contract or arrangement is discussed. As per Rule 15 of the Companies (Meeting of Board and its powers) Rules, 2014, where any director is interested in any contract or arrangement with a related party, such director shall not be present at the meeting during discussions on the subject matter of the resolution relating to such contract or arrangement.

• **Prior approval of Members by means of special resolution**

- ✓ In the following circumstances, in addition to approval of Board of Directors, prior approval of members by means of a special resolution must also be sought before entering into any related party transaction:
 - All related party transactions in case of a company having a paid-up share capital of Rs. 10 Crores or more,
 - Sale, purchase or supply of any goods or materials directly or through appointment of agents exceeding 25% of the annual turnover as mentioned in clause (a) and clause (e) respectively of sub-section (1) of section 188
 - Selling or otherwise disposing of, or buying, property of any kind directly or through appointment of agents exceeding 10% of net worth as mentioned in clause (b) and clause (e) respectively of sub-section (1) of section 188
 - Leasing of property of any kind exceeding 10% of the net worth or exceeding 10% of turnover as mentioned in clause (c) of sub-section (1) of section 188
 - Availing or rendering of any services directly or through appointment of agents exceeding 10% of the net worth as mentioned in clause (d) and clause (e) of sub-section (1) of section 188
 - Appointment to any office or place of profit in the company, its subsidiary company or associate company at a monthly remuneration exceeding Rs. 2.5 Lakhs as mentioned in clause (f) of sub-section (1) of section 188
 - Remuneration for underwriting the subscription of any securities or derivatives thereof of the company exceeding 1% of the net worth as mentioned in clause (g) of sub-section (1) of section 188.
- ✓ The Turnover or Net Worth shall be on the basis of the Audited Financial Statement of the preceding financial year.

- ✓ No member of the company shall vote on such special resolution, to approve any contract or arrangement which may be entered into by the company, if such member is a related party.
- ✓ In case of wholly owned subsidiary, the special resolution passed by the holding company shall be sufficient for the purpose of entering into the transactions between wholly owned subsidiary and holding company.

❖ **Disclosure norms**

• **Disclosures to be made in notice of Board Meeting**

The agenda of the Board meeting at which the resolution is proposed to be moved shall disclose:

- name of the related party and nature of relationship;
- nature, duration of the contract and particulars of the contract or arrangement;
- material terms of the contract or arrangement including the value, if any;
- any advance paid or received for the contract or arrangement, if any; and
- the manner of determining the pricing and other commercial terms, both included as part of contract and not considered as part of the contract;
- whether all factors relevant to the contract have been considered, if not, the details of factors not considered with the rationale for not considering those factors; and
- any other information relevant or important for the Board to take a decision on the proposed transaction.

• **Disclosure by interested directors**

Every director of a company who is in any way, whether directly or indirectly, concerned or interested in a contract or arrangement or proposed contract or arrangement entered into or to be entered into

- with a body corporate in which such director or such director in association with any other director, holds more than 2% shareholding of that body corporate, or
- with a body corporate in which such director is a promoter, manager, Chief Executive Officer of that body corporate; or
- with a firm or other entity in which, such director is a partner, owner or member, as the case may be

shall disclose the nature of his concern or interest at the meeting of the Board in which the contract or arrangement is discussed.

Where any director who is not so concerned or interested at the time of entering into such contract or arrangement, he shall, if he becomes concerned or interested after the contract or arrangement is entered into, disclose his concern or interest forthwith when he becomes concerned or interested or at the first meeting of the Board held after he becomes so concerned or interested.

• **Disclosures to be made in the explanatory statement to be annexed to notice of general meeting:**

- name of the related party ;

- name of the director or key managerial personnel who is related, if any;
- nature of relationship;
- nature, material terms, monetary value and particulars of the contract or arrangement;
- any other information relevant or important for the members to take a decision on the proposed resolution.

- **Disclosures to be made in Board's Report:**

Every related party transaction or contract shall be disclosed in the Board's report along with the justification for entering into such contract or arrangement.

- **Disclosures to be made in Register of contracts or arrangements in which directors are interested**

Every company shall maintain one or more registers in Form MBP 4, and shall enter therein the particulars of contracts or arrangements with a related party with respect to transactions to which section 188 applies.

❖ **Consequences of non-compliance**

- Where any contract or arrangement is entered into by a director or any other employee, without obtaining the consent of the Board or approval by a special resolution in the general meeting, as the case may be, and if it is not ratified by the Board or, as the case may be, by the shareholders at a meeting within three months from the date on which such contract or arrangement was entered into, such contract or arrangement shall be voidable at the option of the Board and if the contract or arrangement is with a related party to any director, or is authorised by any other director, the directors concerned shall indemnify the company against any loss incurred by it.
- Additionally, the company can also proceed against a director or employee who had entered into such contract or arrangement in contravention of the provisions of this section for recovery of any loss sustained by it as a result of such contract or arrangement.
- Any director or any other employee of a company, who had entered into or authorised the contract or arrangement in violation of the provisions of this section shall –
 - (i) in case of listed company, be punishable with imprisonment for a term which may extend to 1 year or with fine which shall not be less than Rs. 25,000/- but which may extend to Rs. 5,00,000/-, or with both; and
 - (ii) in case of any other company, be punishable with fine which shall not be less than Rs. 25,000/- but which may extend to Rs. 5,00,000/-.
