

RELATED PARTY TRANSACTIONS UNDER THE COMPANIES ACT, 2013

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

{ Taking into account notification issued by Ministry of Corporate Affairs dated- August 14th, 2014 })

A. APPLICABILITY OF THE SECTION

Section 188 of the Companies Act , 2013 is applicable to both private companies as well as public companies and is applicable with effect from April 1st , 2014. The Companies Act , 2013 mandates the necessity of the approval of Board of Directors and the approval of shareholders by way of Special resolution passed in the general meeting of the company in order to validate the entering into related party transactions.

B. 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: -

- i. a director or his relative;
- ii. a key managerial personnel or his relative;
- iii. a firm, in which a director, manager or his relative is a partner;
- iv. a private company in which a director or manager is a member or director;
- v. 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;
- vi. 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;
- vii. any person on whose advice, directions or instructions a director or manager is accustomed to act;
- viii. any company which is—
 - a holding, subsidiary or an associate company of such company; or
 - a subsidiary of a holding company to which it is also a subsidiary;
- ix. a director or key managerial personnel of the holding company or his relative with reference to a company shall be deemed to be a related party.

C. TRANSACTIONS WHICH ARE CONSIDERED AS RELATED PARTY TRANSACTIONS

- (a) sale, purchase or supply of any goods or materials;
- (b) selling or otherwise disposing of, or buying, property of any kind;
- (c) leasing of property of any kind;
- (d) availing or rendering of any services;
- (e) appointment of any agent for purchase or sale of goods, materials, services or property;
- (f) such related party's appointment to any office or place of profit in the company, its subsidiary company or associate company; and Related party transactions.
- (g) underwriting the subscription of any securities or derivatives thereof, of the company

D. APPROVALS REQUIRED

I. Related party transactions which require Approval by Board of Directors-

Every company needs to seek the approval of its Board of Directors for entering into any related party transaction, as listed below, irrespective of the capital of the company or the value of the transaction. The transactions which require prior approval of BOD by way of resolution and making of appropriate disclosures in the notice conveying the Board meeting at which the resolution is to be passed, are enlisted hereunder.

- Transactions relating to sale, purchase or supply of any goods or materials
- Transactions relating to selling or otherwise disposing of, or buying, property of any kind;
- Transactions relating to leasing of property of any kind;
- Transactions relating to availing or rendering of any services;
- Transactions relating to appointment of any agent for purchase or sale of goods, materials, services or property;
- Transactions relating to such related party's appointment to any office or place of profit in the company, its subsidiary company or associate company; and Related party transactions.
- Transactions relating to underwriting the subscription of any securities or derivatives thereof, of the company

Where any director is interested in any contract or arrangement with a related party, such director shall not 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.

II. Related party transactions which require Approval of Shareholders by way of Special Resolution- (taking into account notification issued by Ministry of Corporate Affairs dated- August 14th, 2014)

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 transactions in the following circumstances:

- Where a company having a paid-up share capital of INR 10 Crores or more, proposes to enter into a contact or arrangement with any related party; &
- Where a company proposes to enter into any transaction (s) , where the transaction (s) to be entered into-
 - (a) As contacts or arrangements with respect to clauses (a) to(e) of sub section (1) of section 188 with criteria, as mentioned below –

- ❖ Sale, purchase or supply of any goods or materials directly or through appointment of agents exceeding 10% of the turnover of the company or rupees one hundred Crore, whichever is lower, as mentioned in clause (a) and clause (e) respectively of sub-section (1) of section 188 of the Companies Act , 2013;
- ❖ Selling or otherwise disposing of, or buying, property of any kind directly or through appointment of agents exceeding 10% of net worth of the company or rupees one hundred Crore, whichever is lower, as mentioned in clause (b) and clause (e) respectively of sub-section (1) of section 188 the Companies Act , 2013 of the Companies Act , 2013;
- ❖ Leasing of property of any kind exceeding 10% of the net worth of the company or exceeding 10% of turnover of the company or rupees one hundred Crore, whichever is lower, as mentioned in clause (c) of sub-section (1) of section 188 of the Companies Act , 2013;
- ❖ Availing or rendering of any services directly or through appointment of agents exceeding 10% of the turnover of the company or rupees Fifty Crore, whichever is lower, as mentioned in clause (d) and clause (e) of sub-section (1) of section 188 of the Companies Act , 2013;

Explanation- It is hereby clarified that the limits specified in the sub clauses (i) to (iv) shall apply for transaction or transactions to be entered into either individually or taken together with the previous transactions during a financial year.

- (b) Appointment to any office or place of profit in the company, its subsidiary company or associate company at a monthly remuneration exceeding Rs. 2 and half Lakh rupees as mentioned in clause (f) of sub-section (1) of section 188 the Companies Act , 2013
- (c) 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 Companies Act , 2013.

The Turnover or Net Worth referred to hereinabove shall be on the basis of the Audited Financial Statement of the preceding financial year.

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.

E. COMPLIANCES WITH REGARD TO DISCLOSURE

(I) Disclosures in the notice of Board Meeting :

The agenda of the Board meeting at which the resolution is moved shall disclose the following:

- ❖ 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
- ❖ any other information relevant or important for the Board to take a decision on the proposed transaction.

Where any director is interested in any contract or arrangement with a related party, such director shall not be present at the meeting at which the resolution is to be passed during discussion on the subject matter of the resolution relating to such contract or arrangement

(II) Disclosures in the notice conveying the general meeting of the shareholders:

An explanatory statement shall be annexed to the notice conveying the general meeting, shall contain the following particulars-

- ❖ 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.

The provisions mandating approval of the Board of Directors and the Shareholders by way of Special Resolution , shall not apply where-

- The transaction is entered into the ordinary course of business; or
- The transaction is on arm's length.

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.

(III) Disclosure by interested directors –

Every director shall disclose his concern or interest in any company or companies or bodies corporate (including shareholding interest), firms or other association of individuals, by giving a notice in writing.

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 being discussed at the meeting of the board, such director shall disclose his concern or interest at the meeting of the board in which such contract or arrangement is discussed and shall not participate in such meeting. The contract or arrangement in which the director may be interested are enlisted below-

- ❖ Contract or arrangement entered or to be entered 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 is a promoter, manager, CEO of the body corporate; or
- ❖ Contract or arrangement entered or to be entered with a firm or other entity in which, such director is a partner, owner or member, as the case may be

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.

(IV) Disclosure 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.

(V) 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.

F. IMPLICATIONS FOR NON COMPLIANCE WITH PROCEDURE GOVERNING RELATED PARTY TRANSACTION

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.

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.

In terms of section 164, sub section (1) clause(g) of the Companies Act , 2013, a person shall not be eligible to be appointed as a director, if he has been convicted of an offence dealing with the related party transactions under section 188 of the Companies Act , 2013, at any time during the preceding 5 years.

In terms of section 188, sub section (4) of the Companies Act , 2013, the company is authorized to proceed against a director or employee who had entered into such contract or arrangement without seeking the approval of BOD and shareholders in the general meeting i.e in contravention of the provisions of this section for recovery of any loss sustained by it as a result of such contract or arrangement.

PENAL PROVISIONS-

Section 188, sub section (5) of the Companies Act , 2013 enunciates the provisions relating to offences and penalties applicable to any director or any other employee of a company, who had entered into any contract or arrangement in contravention of the provisions of section 188 of the Companies Act , 2013.

Any director or any other employee of a company, who had entered into any contract or arrangement in contravention to the provisions of section 188 of the Companies Act , 2013 shall be subject to penalty as under-

(i) in case of listed company - be punishable with imprisonment or fine or both on directors or other employee of listed company-

- imprisonment up to 1 year; or
- fine up to INR. 5,00,000/- but not less than INR 25, 000; or
- Both ;

(ii) in case of any other company, - be punishable with fine on director or other employee up to INR. 5,00,000/- but not less than INR 25, 000

G. OTHER IMPORTANT DEFINITIONS/ MEANINGS

❖ OFFICE OR PLACE OF PROFIT

The expression “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;

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

The expression “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.

It follows that a transaction is at arm’s length if such a transaction is demonstrably one which could be executed with any party irrespective of the party being a related party. The onus lies on the Board of Directors of the company to ensure that if a particular transaction is not on the arm’s length, the approval by shareholders by way of special resolution is obtained.

❖ INTERESTED DIRECTOR

In terms of section 184 of the Companies Act , 2013 a director who is interested in a transaction of the company is referred to as an Interested Director and he must make appropriate disclosures to the Board of Directors.

An Interested Director shall make disclosure of his concern or interest at the meeting, in the manner enlisted herein below –

- at the first meeting of the Board in which he participates as a director ;
- Subsequently, at the first meeting of the Board in every financial year ;
- whenever there is any change in the disclosures already made, then at the first Board meeting held after such change.

Every director shall disclose his concern or interest in any company or companies or bodies corporate (including shareholding interest), firms or other association of individuals, by giving a notice in writing in **Form No – MBP -1**. All Notices shall be kept at the registered office of the company and shall be preserved for a period of 8 years from the end of financial year to which it relates and shall be kept in the safe custody by the company Secretary of the company, if any, or by any other person authorized by the board for the purpose.

❖ SUBSEQUENT INTEREST IN CONTRACT OR ARRANGEMENT

Where any director who is not concerned or interest at the time of entering into a contract or arrangement with a body corporate or firm or other entity, subsequently become concerned or interested in the contract or arrangements, after the contract or arrangement is entered into shall disclose his concern or interest either –

- Forthwith when he become concerned or interested in such contracts or arrangements.
- at the first meeting of the Board held after he becomes so concerned or interested ;

DISCLAIMER -

This document is prepared on the basis of relevant provisions of The Companies Act, 2013 and rules made there under existing as on date of preparing this document. Readers are advised to refer relevant provision of law before applying any of the point mentioned above. Author accepts no responsibility whatsoever and will not be liable for any loss.

Hope this article would be useful to the readers.

Enjoy The Companies Act, 2013

For any other query and sharing your opinion regarding the article kindly contact on the below mentioned mail ID.

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