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Related Party Transaction

Companies Act, 2013

26/03/2020

GOYAL DIVESH & ASSOCIATES
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This is one of the most important section of Companies Act. If company is entering into any transaction, contract, arrangement etc. Company has to check and comply with provision of this section. **Whenever we are concerned about compliances of related party transaction, we have to check following sections:**

1. **Section 2(76)** – Definition of Related Party Transaction
2. **Section 188**-Related Party Transaction.
3. **Section 189**- Register of transaction in which director are interested

Therefore, in general word one can opine that, combined reading/ compliance of above mentioned 3 sections are required to successfully enter into contract/ arrangement with Related Party.

LET'S START DETAIL STUDY ON SECTION 188

DEFINITION OF RELATED PARTY AND STUDY ON SAME IS COVERED AFTER STUDY OF 188:

Section 188(1) states about contract or arrangement with related party. Compliance of this section is applicable only for the transaction mentioned u/s 188(1) {a to g}.

In simple word if a company entered into any transaction with related party which are not covered in list of transaction of a to g u/s 188, in such

case company is not required to compliance with conditions mentioned in

- 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;
- G) Underwriting the subscription of any securities or derivatives thereof, of the company

Any Transaction with Related party other than mentioned above are out of preview of

Section 188

B. APPROVALS REQUIRED

Audit Committee, if applicable

- Either by: - 1. Meeting;
- Circular Resolution ;
- Ominubs approval (Section 177(4)(iv))

Board of Directors

- For enter into transactions mention under this section Consent of Board of Directors is Require by **Passing of Resolution in the Meeting of Board of Directors**

Shareholders (Ordinary Resolution)

- At Share holder's meeting or postal ballot by resolution (Section 188(1)1st proviso & rule 15) for transaction for limit as mentioend in rule 15

C. RISTRITION ON PARTICIPATION:

- **Board Meeting:**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. [Rule 15(2)]

- **General Meeting:** no member of the company shall vote on such resolution, to approve any contract or arrangement which may be entered into by the company, if such member is a related party for such transaction.

Exemption: Above mentioned restriction of general meeting, shall apply to a company in which ninety per cent. or more members, in number, are relatives of promoters or are related parties

MOST IMPORTANT PROVISION OF SECTION 188

D. **EXEMPTION:** Exemption from compliance of provisions of Section 188.

A. Ordinary Course of Business and Arm Length Basis:

4th Proviso of Section 188(1) play most important role while complying with the provision of this Section:

Nothing in Sec. 188(1) shall apply to any transactions entered into by the company in its ordinary course of business other than transactions which are not on an arm's length basis.

Provisions of Sec. 188(1) are not applicable, if:

- Transaction is in ordinary course of business (+)
- Transaction is on arm's length basis

Company need not to comply followings:

- Board/Shareholder's Approval.
- Restrictions on presence in Board meeting/voting in General meeting.
- Specific disclosures required in agenda of Board meeting & explanatory statement of General meeting

Ordinary Course of Business

- It is not defined under the act or rules.
- The general meaning of the same can be taken as all the usual transactions of a Company.
- **Black's Law Dictionary definition:** the normal routine in managing a trade or business and terms it as regular course of business, ordinary course.
- Factors to be consider: Objects, Nature of Business, History etc.

Arm's Length Basis:

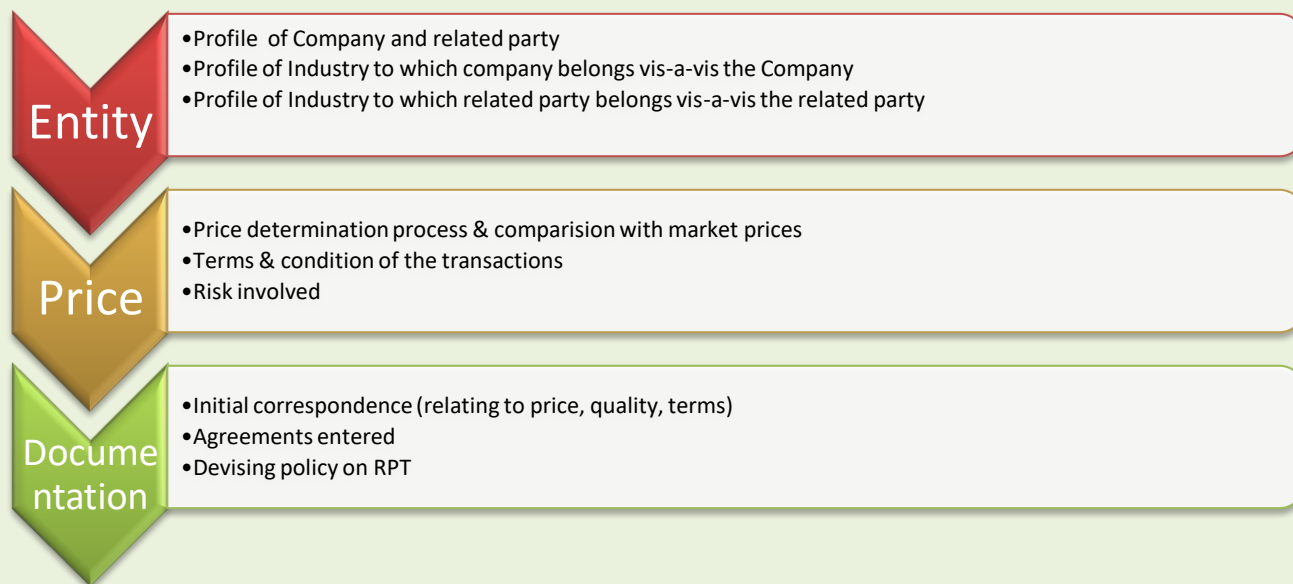
- The expression "arm's length transaction" means a transaction "between two related parties that is conducted as if they were unrelated, so that there is no conflict of interest.

Justification of arm's length:-Justifications can be classified into 3 categories namely entity oriented, price oriented & documentation oriented. Certain

indicators

may

include:-



B. Transaction b/w Holding and WOS:

The requirement of passing the resolution under first proviso shall not be applicable for transactions entered into between a holding company and its wholly owned subsidiary whose accounts are consolidated with such holding company and placed before the shareholders at the general meeting for approval.

In case of wholly owned subsidiary, the resolution is passed by the holding company in their General Meeting shall be sufficient for the purpose of entering into the transaction between the wholly owned subsidiary and the holding company.

AUDIT COMMITTEE & ITS APPROVAL

Constitution of Audit Committee is mandatory for following Companies:

- 1) Every Listed Co.,
- 2) All public cos. with a paid up capital of Rs. 10 crore or more;
- 3) All public cos. having turnover of Rs. 100 crore or more;
- 4) All public cos., having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding Rs. 50 crore or more

COMPOSITION OF AUDIT COMMITTEE:

- Audit Committee shall consist of min. of 3 directors,
- Independent directors forming a majority:
- Majority of members of Audit Committee including its Chairperson shall be persons with ability to read and understand financial statement.

NOTE:

- Every Audit Committee shall act in accordance with terms of reference specified in writing by Board of Directors,
- One of the terms include: Approval or any subsequent modification of transactions of co. with related parties,
- Audit Committee may make Omnibus Approval for RPTs proposed to be entered into by Co.

IMPLICATION:

In case any transaction involving any amount not exceeding Rs. 1 crore is entered into by a director or officer of the company without obtaining the approval of the Audit Committee and it is not ratified by the Audit Committee within 3 months from the date of the transaction, such transaction shall be voidable at the option of the Audit Committee and if the transaction is with the related party to any director or is authorised by any other director, the director concerned shall indemnify the company against any loss incurred by it.

Quick Bite:

Whether all the related party transactions required approval of Audit Committee or the RPT mentioned u/s 188 required approval of Audit Committee?

OMNIBUS APPROVAL OF AUDIT COMMITTEE

As audit committee approval is mandatory for every RPT but in cases where RPTs are entered too frequently its not feasible for the committee to meet every time.

▪ Basis / criteria for granting omnibus approval to include:-

- Maximum value, per transaction & in aggregate
- Disclosure required for obtaining approval
- Periodical review criteria for approved transactions
- Specifying transactions which cannot be approved by omnibus approval

- **Information required for granting omnibus approval:** Particulars which need to be mentioned in Omnibus Approval Resolution :-
 - Name of Related Parties, Nature & Duration of Transaction
 - Maximum Amount of Transaction
 - Indicative base price and formula for variation

Approval of Omnibus transaction without fulfilling the above criteria:

Special Condition: However, in cases where the above information is not available & need for obtaining approval cannot be foreseen then approval may be given subject to value not exceeding Rs. 1 crore.

DUTY OF AUDIT COMMITTEE:

The audit committee shall review (at such interval as the Audit Committee may deem fit) the details of related party transactions entered into by the Company pursuant to **Each** of the omnibus approvals given.

TERM OF OMNIBUS APPROVAL:

Omnibus approvals shall be valid for a period **not exceeding one year** and shall require fresh approvals after the expiry of one year.

NOTE:

- Omnibus approval shall not be made for transactions in respect of selling or disposing of the undertaking of the Company.^{Clause-6}
- Any other conditions as the Audit Committee may fit.

BOARD OF DIRECTORS & ITS CONSENT

Approval of Board of Directors:

No co. shall enter into any contract/arrangement with related party w.r.t. certain transactions, except with Board of Directors consent given by resolution at its meeting.

Interested Director:

Where any director is interested in any contract/arrangement with related party, such director shall not be present at meeting during discussions on subject matter of resolution relating to such contract/arrangement.

Board meeting's Agenda shall disclose:

1. Name of related party and nature of relationship;
2. Nature, duration of contract and particulars of contract / arrangement;
3. Material T&C of contract / arrangement including value, if any,
4. Any advance paid/received for contract/arrangement, if any;
5. Manner of determining pricing and other commercial terms, both included as part of contract and not considered as part of contract;
6. Whether all factors relevant to contract have been considered, if not, details of factors not considered with rationale for not considering those factors; and
7. Any other info. Relevant / important for Board to take a decision on proposed transaction.

SHAREHOLDERS' APPROVAL

Where paid-up share capital / transaction exceeds prescribed limits, Co. shall enter into contract/arrangement after obtaining prior shareholder's approval by Ordinary Resolution.

**** Member shall not vote on such resolution, if such member is a related party**

Exemption to above restriction:

Now This proviso will not apply on Private Limited Company.

"Even if, Member is related then also he can vote on such resolution required to be pass u/s 188 in GM."

- a) This restriction shall not apply to a company in which ninety per cent. or more members, in number, are relatives of promoters or are related parties.
- b) Does not apply to transactions between 2 Govt. companies or if the Govt. companies obtains approval of ministry in charge.
- c) Does not apply to a Section 8 (Not for profit Company) if value of transaction is upto Rs. 1,00,000/- (Rupees One Lakh).

Threshold for Shareholders Approval:

Contract / Arrangement with related party with respect to:	Revised Threshold
Sale, purchase or supply of any goods or materials	10% or more of the turnover
Selling or otherwise disposing of, or buying, property of any kind	10% of net worth of the company
Leasing of property of any kind	10% or more of the turnover
Availing or rendering of any services	10% or more of the turnover
Appointment of any agent for purchase or sale of goods, materials, services or property	10% or more of the turnover
It is hereby clarified that the limits specified in sub-clause (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.	
Such related party's appointment to any office or place of profit in the company, its subsidiary company or associate company	Monthly remuneration exceeding Rs. 2,50,000/-
Underwriting the subscription of any securities or derivatives thereof, of the company	Remuneration exceeding 1% of the net worth.
The turnover or net worth referred in the above sub-rules shall be computed on the basis of the audited financial statement of the preceding financial year.	

DISCLOSURES REQUIRED FOR RPT's

Every contract / arrangement entered into u/s 188(1) shall be referred to in Board Report to shareholders along with justification for entering into such contract / arrangement.

Board Report should include particular of contracts with related party.

Form AOC – 2 as prescribed in Cos. (Accounts) Rules, 2014 is divided in 2 parts, namely

1. Details of contracts/ arrangements/ transactions not at arm's length basis,
2. Details of material contracts/ arrangement/ transactions at arm's length basis.

RATIFICATION OF 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 resolution in the general meeting under sub-section (1) 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 or, as the case may be, of the shareholders.

If any related party transaction entered by Company without approval of Board of Directors and Shareholders such transaction can be approved by Board and General Meeting within 3 months of entering into transaction.

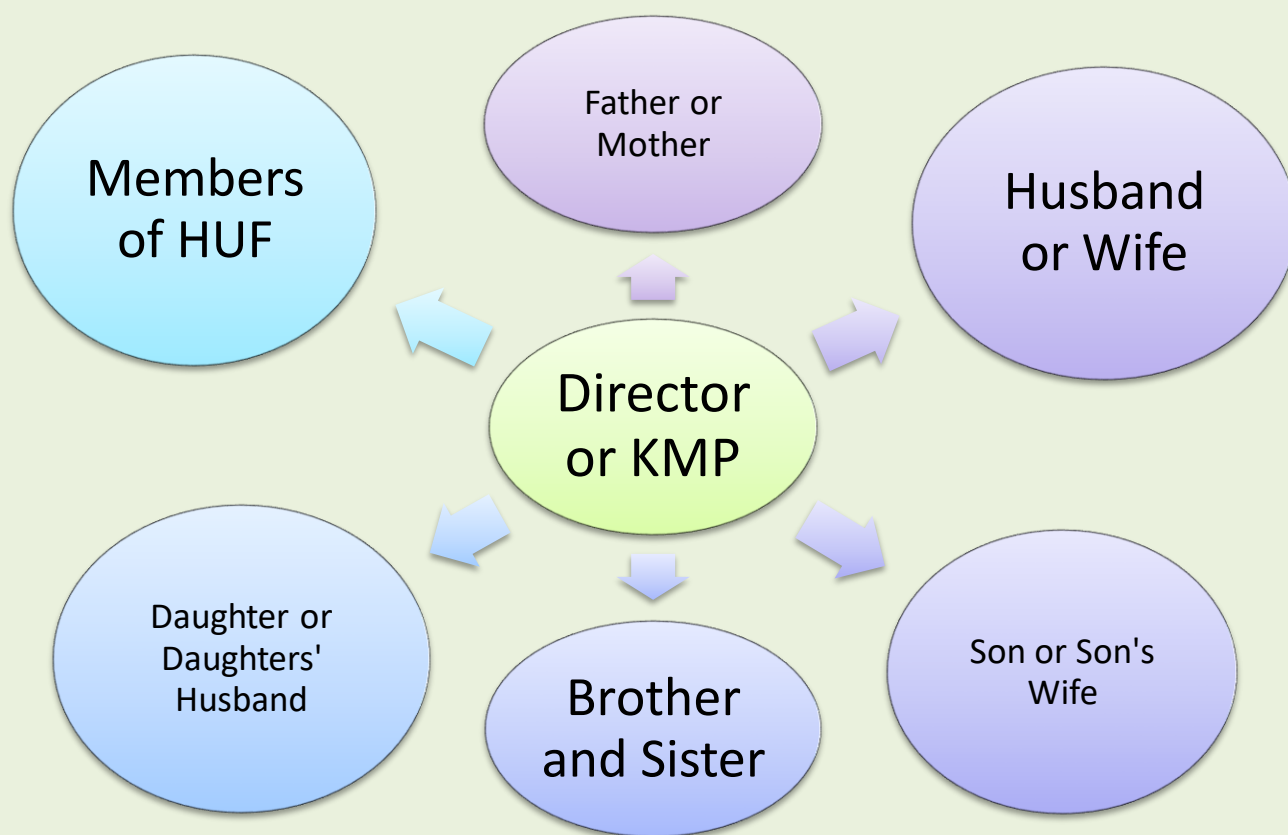
CHECKS - RELATED PARTY TRANSACTION

- I. Transaction entered into by 'Company' (as one party)
- II. Transaction is with 'Related Party'
- III. Transaction is a "Prescribed Transaction as per 188"
- IV. Whether transaction is in "Ordinary Course of Business"?
- V. Whether RPT is at 'arms' length basis?

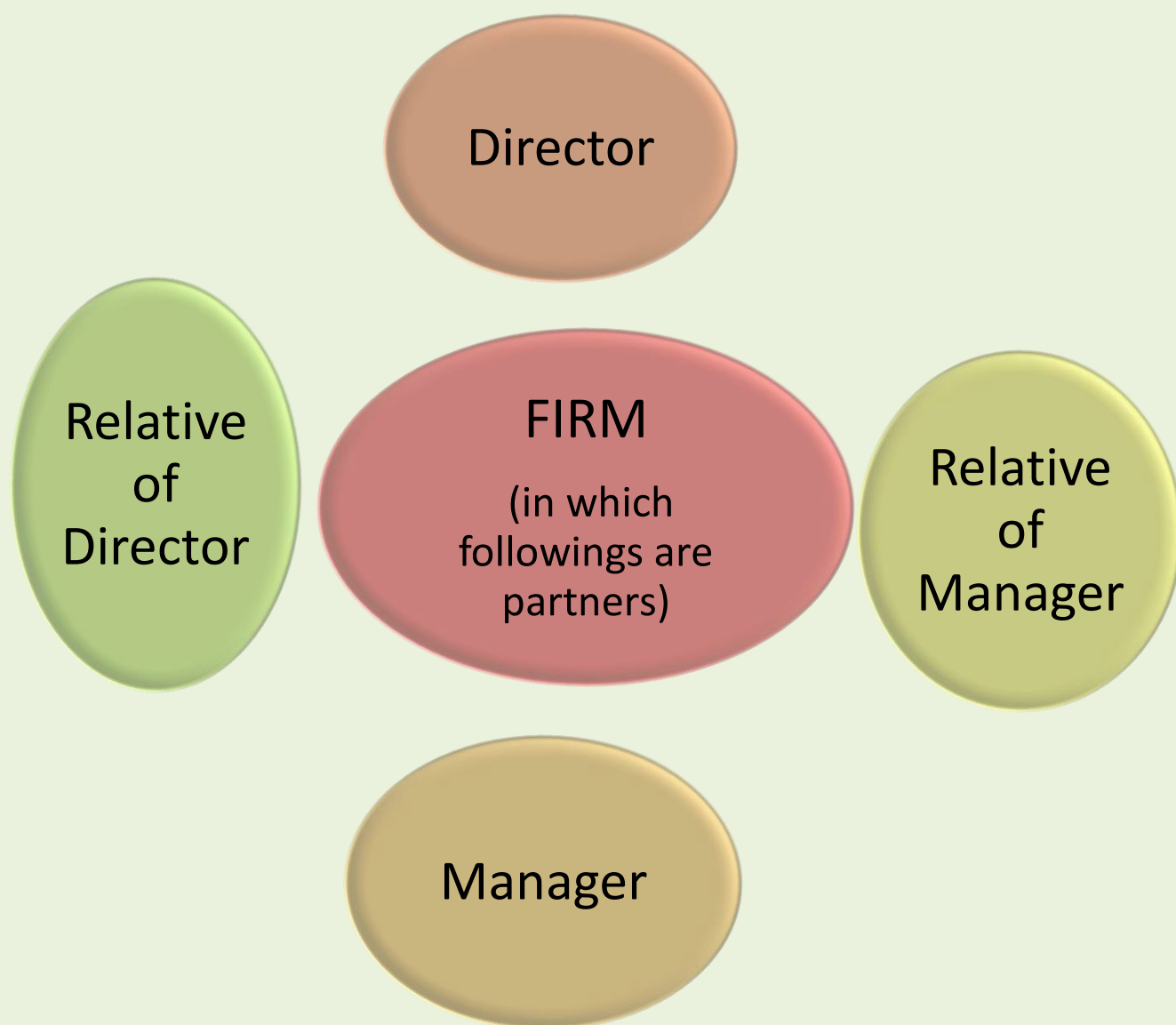
- ☐ Before entering into any transaction, First check above mentioned first 3 clauses.
- ☐ If Company satisfied first 3 conditions then check further 2 clauses.

WHO ARE RELATED PARTIES?

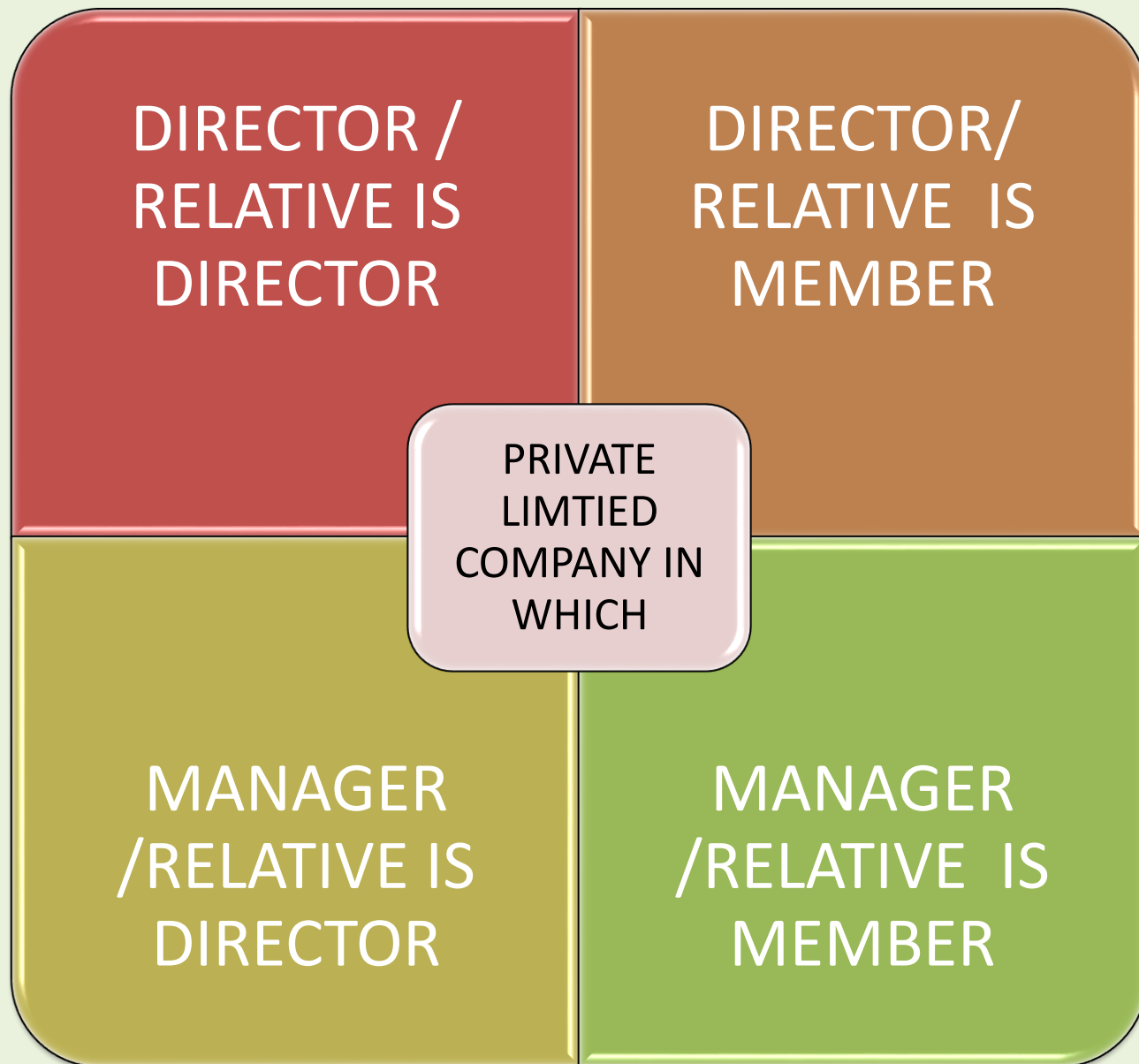
First Category:



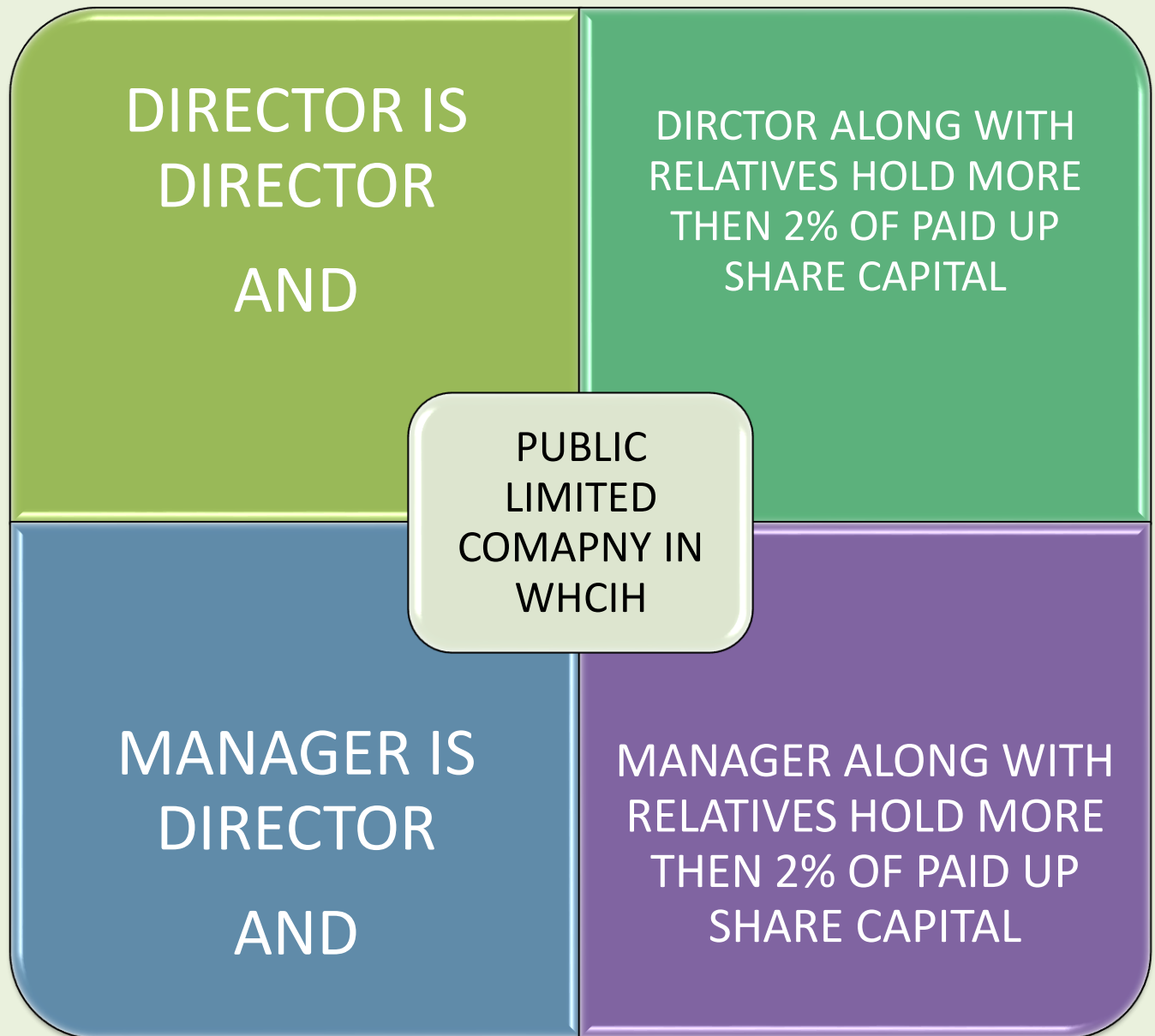
Second Category:



Third Category:



Fourth Category:



Food for Thought:

Whether calculating the limit of 2% preference share capital shall be considered or not?

Fifth Category:

Any Body Corporate whose

- Board of Directors,
- MD or
- Manager

is accustomed to act in accordance with the advice, directions or instructions of a director or manager.

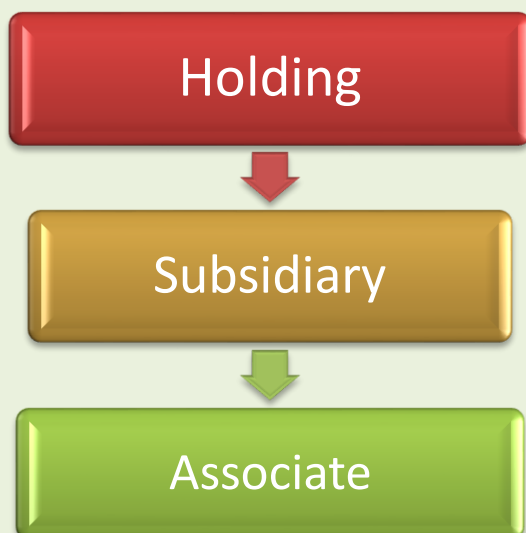
Sixth Category:

Any person on whose Advice, Directions or Instructions a Director or Manager is accustomed to act.

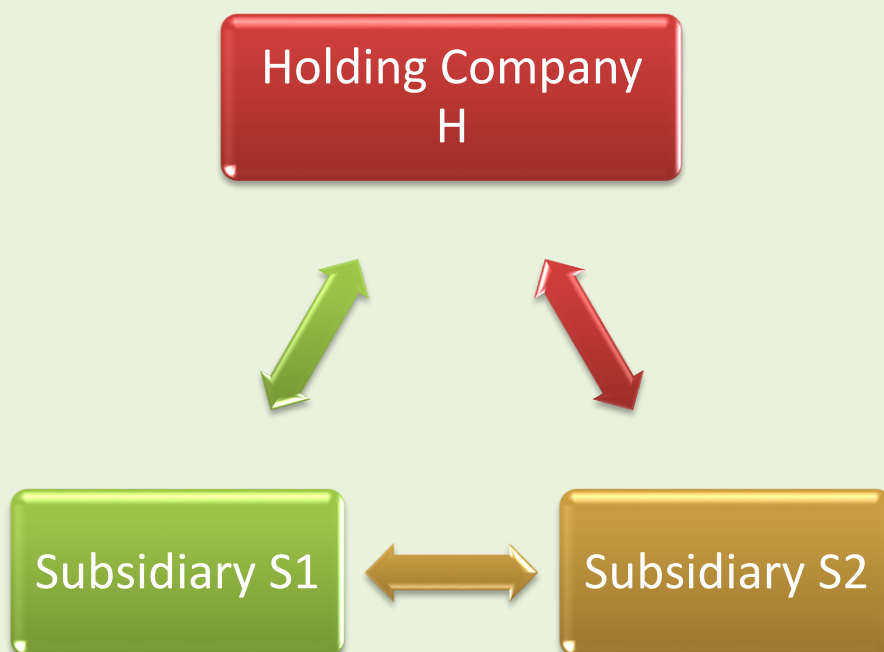
Provided that nothing in sub-clauses (vi) and (vii) shall apply to the advice, directions or instructions given in a professional capacity;

Seventh Category:

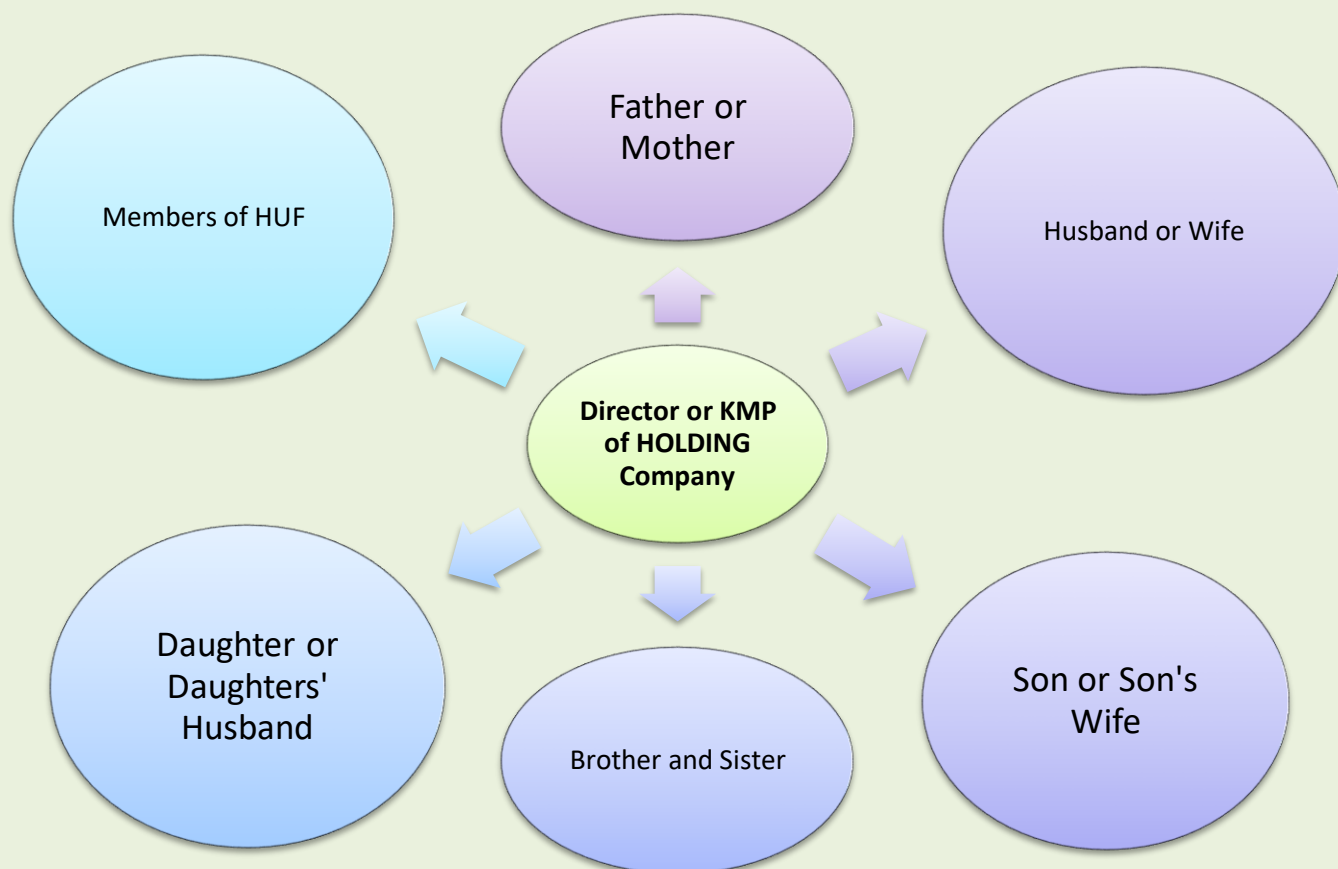
Any Body Corporate which is—**A**



B.



Eight Categories:



DIFFERENCE BETWEEN - RELATED PARTY AND RELATIVE

Food for Thought:

- A. Whether a Company can have Relatives?
 - B. Whether Directors / KMP's can have Related Parties?
 - C. Whether an HUF can be related Party.
 - D. What is meaning of Related Party for private Limited Company?
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EXEMPTION - PRIVATE LIMITED COMPANY

Definition of Related Party relaxed with respect to Section 188

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

- (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 [or his relative] is a member or director;
- (v) a public company in which a director or manager is a director [and] holds along with his relatives, more than two per cent. 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:

Provided that nothing in sub-clauses (vi) and (vii) shall apply to the advice, directions or instructions given in a professional capacity 10

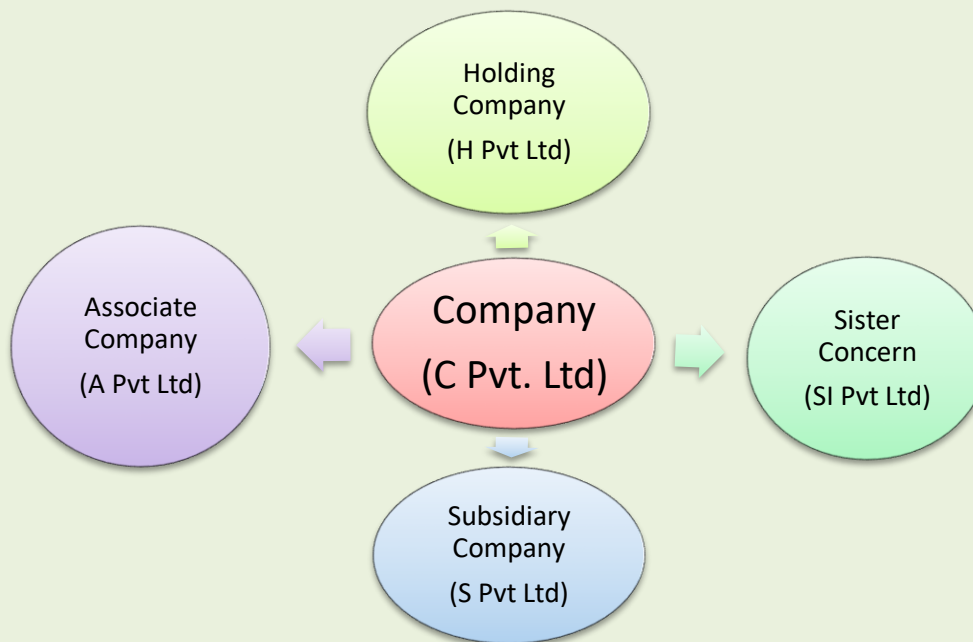
(viii) any company which is—

(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;

(ix) such other person as may be prescribed;

For the purpose of transactions u/s 188



Quick Bites

A. If C Pvt. Ltd entering into a RPT u/s 188 with S Pvt. Ltd or H Pvt. Ltd, Whether it will be treated as RPT and whether compliances of 188 needs to be done?

B. If H Pvt. Ltd. entering into transaction u/s 188 with S Pvt. Ltd. and there is a common director between both the Companies.
Whether such transaction shall be treated RPT u/s 188 or not?

C. Whether H/S/SI shall be considered as Related Party under Companies Act, 2013.

Quick Bites

- A. Transaction by a Company with related party-such transaction is not 'prescribed transaction' under Section 188 (a to g) of the Companies Act, 2013. Whether provisions of Section 188 attracts?
- B. Transactions mentioned u/s 188 with a party, which is not related party?
- C. Transactions entered by A Limited with B Limited.
- a) Both having common Directors, whether A and B shall be considered as Related Parties?
 - b) Directors of A limited hold 25% of paid up capital of B Limited. However, directors are not common.
 - c) Relatives of Directors of A limited hold 25% of paid up capital of B Limited. However, directors are not common
- D. Whether a LLP can be related party, where no Directors or relative of directors are partners in LLP?
- E. Preferential allotment to promoters of Company shall be considered as Related Party Transaction?
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MEANING OF 'OFFICE OR PLACE OF PROFIT'

Office is held by Director: 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.

Office is held by an individual other than a director or by any firm, private co. or other body corporate:

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.

Quick Bites:

1. Increase in remuneration of Director shall be considered as Related Party transaction?
2. Appointment of Director or related party in Holding Company for office and place of profit shall be considered as related party transaction?
3. If Mr. A Faineance manager of Company appointed as Director of Company, whether this transaction shall be considered as related party transaction.

4. Mrs. X is Director of ABC Ltd. Co. proposes to appoint Mrs. P daughter as Director
5. Mr. A directors in ABC Insurance Limited. Mr. A proposes to take any insurance from Company ABC Insurance Limited?

F. Whether Board resolution u/s 188(1) passed by Circular Resolution?

G. Whether company need to file MGT-14 for resolution passed by Shareholders of Company?

PARTICULARS TO BE ENTERED IN REGISTER

As per Section 189 read with rule 16 a register shall be maintained and kept at the registered office for recording particulars of the following:-

A. Entities in which any Director is having concern/interest u/s 184(1)

S.N.	Particulars	S.N.	Particulars
1.	Name of entity	4.	Nature of concern/interest or change in them
2.	Name of interested Director	5.	Date on which concern/interest arose/ change
3.	Shareholding, if any		

C. Contracts or agreements with related party u/s 188 OR in which any director is concerned / interested u/s 184(2)

S.N.	Particulars	S.N.	Particulars
1.	Date & Amount of Contract/arrangement	9.	Date of next meeting at which register was placed for signature
2.	Name of party with which contract is entered		
3.	Name of interested Director	10.	Date of shareholder's approval, if any
4.	Nature of concern/interest		
5.	Principal terms & conditions	11.	Reference to specific clause (a) to (g) of section 188(1)
6.	Whether transaction at arm's length		
7.	Date of Board approval	12.	Remarks, if any
8.	No. of Directors present, voting in favour, against or remaining neutral		

Other Requirements pertaining to Registers:-

- Disclosure of info. as required u/s 184(1) to be given by Director/KMP within 30 days of appointment, failure would attract penalty of Rs. 25,000/-.
- Register shall be placed at Board meeting & be signed by all Directors present thereat.
- Register shall be produced at and shall remain open and accessible during AGM.
- Register shall be open for inspection and extracts may be given on payment of amount prescribed in AOA (max. Rs. 10) within max. 7 days of request.

Duty to Directors: As per section 166,

- a director of company shall not involve in a situation in which he may have a direct/indirect interest that conflicts or may conflict with interest of the Company.
- Not achieve/ attempt to achieve any undue gain either to himself or to any of his relatives, partners or associates and if found guilty then liable

Duty of Independent Director:- Independent Director shall pay sufficient attention and ensure that adequate deliberations are held before approving related party transactions and assure themselves that the same are in the interest of Company (schedule IV, para III-point 9)

CONSEQUENCES OF NON-COMPLIANCE

Ratification:- If Board/Shareholder's approval not taken before entering into RPT, then same can be ratified by Board/Shareholders within 3 months. If ratification not done then Contract/arrangement voidable at the option of Board.

Indemnification:- If transaction was with related party of Director/authorized by any director then he shall indemnify the company against loss incurred.

Recovery of loss:- Company may proceed against a Director/employee who has entered into such contract/arrangement in contravention of section 188 for recovery of loss.

Penalty:-

	LISTED COMPANIES	OTHER
Imprisonment	Max. 1 year	NA
Fine(min.)	Rs. 25000	
Fine (max.)	Rs. 500000	



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