

Whether transaction between group companies requires compliance of Related Party Transactions?

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Introduction

1. The provisions relating to 'Related Party Transactions' have been incorporated for the first time in the Indian Company Law under the provisions of Section [188](#) of the Companies Act, 2013. Under the Companies Act, 1956, there was no explicit provision as 'Related Party Transaction'. However, it can be said that Section [297](#) of the Companies Act, 1956 slightly corresponds to Section 188 of the Companies Act, 2013. The scope and nature of transactions, number of related parties involved, compliance and disclosure requirements contemplated have significantly been enhanced under the provisions of Section 188 of the Companies Act, 2013.

Prerequisites of compliance of Section 188 of the Companies Act, 2013

2. For the purpose of identifying 'Related Party Transaction', the Compliance Officer has to ensure compliance of all the following three conditions:

- (i) Transaction is entered into by a Company, i.e., One of the parties shall be a company – private company or public company (Section 188 of the Companies Act, 2013),
- (ii) The transaction is entered into with a 'related party' (as defined in Section 2(76) of the Companies Act, 2013),
- (iii) Such transaction is a 'prescribed transaction' (as defined in Section 188 of Companies Act, 2013).

If all the above three conditions are satisfied, the Compliance Officer shall proceed with the compliance and disclosures under the provisions of Section 188 of the Companies Act, 2013. In following three cases, provisions of 'Related Party Transactions' are not applicable:

- (i) LLP enters into a transaction with its partner, who is a director in a company,
- (ii) Transaction by a Company with related party-such transaction is not 'prescribed transaction' under Section 188 of the Companies Act, 2013.
- (iii) Transaction by a Company with a party, which is not a 'related party' under Section 2(76) of the Companies Act, 2013.

Prescribed Transactions

3. The transaction entered into by a company with its related party shall be a prescribed transaction under Section 188 of the Companies Act, 2013. Interestingly, such transaction can be in the form of a contract or arrangement. Following are the 'prescribed transactions', as provided in Section 188(1) of the Companies Act, 2013:

- (i) Sale, purchase or supply of any goods or materials;
- (ii) Selling or otherwise disposing of, or buying property of any kind;
- (iii) Leasing of property of any kind;
- (iv) Availing of or rendering of any services;
- (v) Appointment of any agent for purchase or sale of goods, materials, services or property;
- (vi) Such related party's appointment to any office or place of profit in the company, its subsidiary company or associate company; and
- (vii) Underwriting the subscription of any securities or derivatives thereof, of the company.

Related Parties

4. Related parties have been defined in Section [2\(76\)](#) of the Companies Act, 2013. Related Party with reference to a company means:

- (i) Director or his relative;
- (ii) Key managerial personnel or his relative;
- (iii) Firm in which a director manager or his relative is a partner;
- (iv) Private company in which a director or manager or his relative is a member or director;
- (v) 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;
- (viii) Any company which is: (A) Holding, subsidiary or an associate company of such company; or (B) Subsidiary of a holding company to which it is also a subsidiary;
- (ix) Such other person as may be prescribed.

With reference to the third condition for the compliance of Section 188 of the Companies Act, 2013, the transaction shall be entered into by the company with any of the above related parties.

The question posed in the article is whether group companies are 'related parties'. To discuss this further, it is necessary to decipher the related

parties. 'Related parties', in relation to the present question are as follows:

- (i) Private Company in which a Director or Manager or his relative is a Member or Director;
- (ii) Public Company in which a Director or Manager is a Director and holds, along with his relatives, more than 2% of its paid-up share capital.

Interestingly, the criteria for a company to be a 'related party' to another company are different, as it depends on whether the other company is a private company or a public company.

'Private Company' as Related Party

5. Let's take an example of W Ltd. and P Pvt. Ltd. P Pvt. Ltd. is a 'related party' to W Ltd., if any of the following condition is satisfied:

- (i) W Ltd.'s Director is a Director in P Pvt. Ltd.,
- (ii) W Ltd.'s Manager is a Director in P Pvt. Ltd.,
- (iii) W Ltd.'s Director is a Member in P Pvt. Ltd.,
- (iv) W Ltd.'s Manager is a Member in P Pvt. Ltd.,
- (v) W Ltd.'s Director's relative is a Director in P Pvt. Ltd.,
- (vi) W Ltd.'s Manager's relative is a Director in P Pvt. Ltd.,
- (vii) W Ltd.'s Director's relative is a Member in P Pvt. Ltd.,
- (viii) W Ltd.'s Manager's relative is a Member in P Pvt. Ltd.

In the given case for determining private company as a 'related parties', the requirement is only to be a director or member and not both.

'Public Company' as Related Party

6. Let's take an example of X Ltd. and G Ltd. X Ltd. is a 'related party' to G Ltd., if any of the following condition is satisfied:

- (i) X Ltd.'s director is Director in G Ltd. and director (along with his relatives) holds more that 2% paid-up capital of G Ltd.,
- (ii) X Ltd.'s director is Manager in G Ltd. and Manager (along with his relatives) holds more that 2% paid-up capital of G Ltd.,

6.1 In the following cases, X Ltd. and G Ltd. are not related parties

- (i) X Ltd. and G Ltd. have common directors, but there is no shareholding of X Ltd.'s directors in G Ltd.,
- (ii) X Ltd. and G Ltd. have common managers, but there is no shareholding of X Ltd.'s Managers in G Ltd.,
- (iii) Director of X Ltd. is holding 20% shares in G Ltd., however, not appointed as director in G Ltd.,
- (iv) Manager of X Ltd. is holding 20% shares in G Ltd., however, not appointed as director in G Ltd.,
- (v) Relative of the Director in X Ltd. is holding 20% shares in G Ltd., however, not appointed as director in G Ltd.,

(vi) Relative of Manager of X Ltd. is holding 20% shares in G Ltd., however, not appointed as director in G Ltd.

Therefore, for a Public Company to be a 'related party' to another company, if there is mandatory requirement of common directors and director's shareholding (either by themselves or through director's relatives) is more than 2% of its paid-up share capital. Interestingly, the reference is to 'paid-up share capital', i.e., equity shares or preference shares.

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7. Coming to the moot question, as a thumb rule Compliance Officers should not conclude that common directorships in 2 or more companies amounts to 'related parties' under the Companies Act, 2013. It will be necessary to verify the shareholding of director's or director's relative, in the other company. In case of Private Company and based on common directorships, it can be said that 2 companies are 'related parties'. For a public company to be a 'related party', it requires the common directors and director's shareholding (directly or indirectly).

If a prescribed transaction is entered into by the group companies which are not 'related parties' under Section 2(76) of the Companies Act, 2013, then the provisions of Section 188 of the Companies Act, 2013 are not required to be complied with. In such case, the Compliance Officer is not required to verify whether the transaction is on arm's length basis or in the ordinary course of business.

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