

Overview of Related Party Transactions under Companies Act, 2013

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'Related Party Transactions' ('RPTs') is one of the very crucial provisions of the Companies Act, 2013, which has affected all companies and their transactions with related parties since the implementation of the Companies Act, 2013. Section 188 of the Companies Act, 2013 relates to the RPTs. Under the Companies Act, 1956, the corresponding provisions (though not directly) were Section 297 (referring to the 'Board's sanction to be required for certain contracts in which particular directors are interested') and Section 314 (referring to 'Director, etc. not to hold office or place of profit'). Section 188 of the Companies Act, 2013 is an extension of Section 297 and 314 of Companies Act, 1956, wherein the nature of transactions, number of parties, compliance and disclosure

requirements have been significantly increased.

The authors assist the readers in understanding the basics of RPTs, related parties, arms' length transaction, complexities involved in compliance and reporting, etc.

Synopsis: 'Related Party Transactions' ('RPTs') is one of the very crucial provisions of the Companies Act, 2013, which has affected all the companies and their transactions with related parties since the implementation of the Companies Act, 2013. Section 188 of Companies Act, 2013 refers to the RPTs. The authors assist the readers in understanding the basics of RPTs, related parties, arms' length transaction, complexities involved in compliance,

reporting, etc.

BASIC INGREDIENTS FOR A TRANSACTION TO QUALIFY AS AN "RPT":

In accordance with provisions of Section 188(1) of the Companies Act, 2013, the company is required to obtain the consent of the Board of Directors at a board meeting, subject to certain prescribed conditions, for entering into contract or arrangement with a related party. Therefore, the essential ingredients of RPTs are:

1. Company is a 'transacting party',
2. Transacting party enters into contract or arrangement with prescribed 'related parties',
3. Such a contract or arrangement is for 'prescribed transactions'.

If the 'transacting party', is a sole proprietary, partnership firm, Hindu Undivided Family or Limited Liability Partnership, then the provisions relating to Section 188 of the Companies Act, 2013 are not applicable at all. The transacting party must be a 'company' only – a private or public company.

On June 5, 2015, the Ministry of Corporate Affairs ('MCA') issued a notification wherein certain exemption and relaxations have been provided for private companies. Vide the MCA notification, in relation to private company, the entities specified in Section 2(76)(viii) of Companies Act, 2013 would not be considered 'related parties' under Section 188 of the Companies Act, 2013. Therefore, the relationship between a private company (i.e. transacting company) with the following parties will not be considered as a 'related party':

- (a) Holding company,
- (b) Subsidiary company,
- (c) Associate company,
- (d) Another subsidiary company of the holding company.

A private company that is a transacting company, is not required to comply with the provisions of Section 188 of the Companies Act, 2013 if it enters into a contract or arrangement with the above-mentioned parties.

SHAREHOLDERS' APPROVAL:

The first proviso to Section 188 of the Companies Act, 2013 contemplates the prior approval of shareholders by an ordinary resolution (vide the Companies Amendment Act, 2015) for a contract or arrangement, wherein the paid-up share capital of the transacting company or amount of transaction breaches the prescribed threshold. The thresholds as prescribed in the Rule 15 of Companies (Meetings of Board and its Powers) Rules, 2014 are mentioned in below table :

The second proviso to Section 188 of the Companies Act, 2013 prohibits the member of the company from voting on the ordinary resolution approving the proposed contract or arrangement, if such member is a 'related party'.

The Ministry of Corporate Affairs

issued Circular No. 30 / 2014 on July 17, 2014, whereby it clarified the scope of the second proviso to Section 188(1) of the Companies Act, 2013. MCA has clarified that the 'related party' referred to in the proviso is to be construed with reference only to the contract / arrangement for which the resolution is passed and the term 'related party' refers to such a 'related party' in context of the contract or arrangement for which resolution is being passed.

TRANSACTION IN THE ORDINARY COURSE OF BUSINESS (+) ARMS' LENGTH :

The third proviso to Section 188 of the Companies Act, 2013 carves out an exception, whereby the provisions of Section 188(1) (Requiring consent of the Board of Directors and the shareholders of the company for entering into contract or arrangement with a related party for a certain prescribed transactions, as discussed above) are not applicable if the transaction to be entered into by the company is :

- (i) in the ordinary course of business and,

Clause of Section 188 of the Companies Act, 2013	Contract or Arrangement with a related party with respect to:	Prescribed Threshold
(a)	Sale, purchase or supply of any goods or materials	10% of the turnover or Rs. 100 crore, whichever is lower.
(b)	Selling or otherwise disposing of, or buying, property of any kind	10% of net worth of the company or Rs. 100 crore, whichever is lower.
(c)	Leasing of property of any kind	10% of the net worth of the company or 10% of turnover of the company or Rs. 100, whichever is lower.
(d)	Availing or rendering of any services	10% of the turnover of the company or Rs. 50 crore, whichever is lower.
(e)	Appointment of any agent for purchase or sale of goods, materials, services or property	10% of the turnover of the company or Rs. 50 crore, whichever is lower.
(f)	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/-
(g)	Underwriting the subscription of any securities or derivatives thereof, of the	Remuneration exceeding 1% of the net worth.

on an arm's length basis.

Explanation (b) to Section 188(1) of the Companies Act, 2013 explains the expression 'arm's length transaction' as a transaction between two related parties that is conducted as though they were unrelated, so that there is no conflict of interest. However, there is no guidance or reference to the meaning of 'ordinary course of business' in the Companies Act, 2013.

The transacting company cannot benefit from the third proviso to Section 188(1) of Companies Act, 2013 in the following cases :

- (i) Transaction is in the ordinary course of business but not at arms' length,
- (ii) Transaction is not in the ordinary course of business but at arms' length.

It is necessary to fulfill both the conditions, transaction in the ordinary course of business and at arms' length, to claim an exemption from Section 188(1) of the Companies Act, 2013 requiring consent of the Board of Directors and the shareholders).

DEADLOCK SITUATIONS IN GENERAL MEETINGS :

Section 188 of the Companies Act, 2013 provides that if a member of the company is a related party, he may not vote to approve any contract or arrangement. This provision was further clarified by the Ministry of Corporate Affairs in a Circular, specifying that the term 'related party' in this context would only refer to the related party that is a 'related party' in the context of the contract or arrangement, for which a resolution is passed by the members.

Vide the MCA Notification dated June 5, 2015; the second proviso to sub-section (1) of Section 188 of the Companies Act, 2013 is not applicable to private companies. Therefore, in case of private companies where a particular contract or arrangement requires the approval of members, the member of the company, who is a related party, can also vote on the ordinary resolution, i.e. such a member is not restrained from voting as contemplated by the second proviso to sub-section (1) of Section 188 of the Companies Act, 2013.



AUDIT COMMITTEE APPROVAL

However, public companies – listed or unlisted – are under obligation to ensure that such related parties are restrained from voting on the ordinary resolution placed before shareholders for approval.

AUDIT COMMITTEE APPROVAL:

In accordance with the provisions of Sec. 177(4)(iv) of CA, 2013, the audit committee (wherever required to be constituted) sanction is required for approval or any modification of RPTs with the company. Such approval is required for any RPT irrespective of any threshold, whether such transaction is at arm's length and in ordinary course of business or not. This means that every transaction must be placed before the audit committee for approval.

DISCLOSURES OF RPTs IN BOARD'S REPORT

Sec. 188(2) of the Companies Act, 2013 provides that every contract or arrangement entered u/s 188(1) shall be reported in the Board's report, along with the justification for entering into such contract or arrangement. This would essentially mean that transactions which are either not at arm's length or not in ordinary course of business would need to be disclosed in Board Report along with justification.

However, the format (i.e. Form AOC-2) prescribed for disclosure of RPTs in the Board's Report has expanded the scope by even including the transactions that are at arm's length.

This has made procedural compliance more difficult for companies, resulting in an information overload for stakeholders, thereby making the Board's Report irrelevant to some extent.

NEED FOR ANOTHER ROUND OF OVERHAULING RPTs PROVISIONS

With the objective of "ease of doing business" in India and addressing the key RPT implementation issues, the Ministry of Corporate Affairs and government have taken adequate steps (over the past year) for overhauling the provisions of RPTs in the Companies Act, 2013. The efforts include passing the Companies (Amendment) Bill, 2014, issuing circulars, notifications, amending the provisions through Removal of Difficulty Orders. However, there is a pressing need for providing detailed guidance on the terms "ordinary course of business" & "arm's length transaction".

It is equally important that every company, senior management, and key managerial personnel understand the impact of these provisions, and accordingly implement appropriate checks and balances for ensuring the effective implementation of the RPTs provisions in their companies / group companies.

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