

ICSI's guidance note on Related Party Transactions

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Introduction

1. The manner in which the company (listed or unlisted) complies with the provisions of Related Party Transactions determines the commitment level towards Corporate Governance norms. Other than check-list oriented compliances, following are the important aspects w.r.t. related party transactions:

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- (1) Disclosure of interest,
- (2) Avoiding conflict of interest,
- (3) Fiduciary duty of a director towards the company and other directors,
- (4) Transparency and disclosures.

1.1 *The compliance under related party transactions covers the following aspects*

- (1) Approval of Audit Committee, consent of board of directors and approval of shareholders,
- (2) Voting or restriction from voting at the meeting (shareholders meeting or board meeting),
- (3) Recording of related party transactions in register maintained under the Companies Act,
- (4) Disclosures in the Board's Report, Explanatory Statement (in case of approval of shareholders is required), agenda (in case of consent of board of directors and approval of Audit Committee),
- (5) Maintenance of certain documents, records and information for the purpose of compliance of the provisions relating to related party transactions (Valuation report or documents w.r.t. arm's length transactions, etc.)

Taking into consideration the prior relationship between the parties, the provisions relating to related party transactions are very crucial due to the following reasons:

- (1) Pricing aspect of the transaction,
- (2) Terms and conditions of the transaction,
- (3) Whether such transaction is on arm's length basis? What are the factors for determining arm's length basis transaction?
- (4) Whether such transaction is in the ordinary course of its business? What are the factors for determining such ordinary course of business?
- (5) Whether the transaction is in the interest of the company and shareholders?

ICSI's Guidance Note on related party transactions

2. Taking into consideration the above complexities, interpretational issues and practical issues in compliances of some subjective factors (*i.e.*, ordinary course of business or arm's length pricing), the Secretarial Standard Board of ICSI has formulated Guidance Note on Related Party Transactions. The 93-page Guidance Note explains the rationale, procedure, practices and compliances associated with the provisions relating to related party transactions.

The scope of the Guidance Note on related party transactions is quite wide and covers the provisions under the Companies Act, 2013, Rules under the Companies Act, 2013, Companies (Auditor's Report) Order, 2016, Indian Accounting Standards - 24, Accounting Standards - 18, Secretarial Standards. Based on these, Guidance Note on related party transactions covers 13 important points (covered under sections 177, 184, 188, 189 of the Act and the SEBI (Listing Obligation and Disclosure Requirement) Regulations, 2015). The coverage of the Guidance Note on related party transactions is as follows:

- (1) Meaning of the terms used in the context of transactions with related parties,
- (2) Meaning of related party,
- (3) Meaning of related party transactions,
- (4) Legal Mechanism pertaining to Related Party Transactions,
- (5) Board processes,
- (6) Approval requirements (under Companies Act and SEBI Listing Regulations),
- (7) Disclosures by directors,
- (8) Maintenance of registers and records,
- (9) Policy on Related Party Transactions,
- (10) Penalty and prosecution for non-compliance of related party transactions,
- (11) Ratification of transactions with related party,
- (12) Audit of related party transactions,
- (13) Best practices.

The phrase 'ordinary course of business' has been referred to in section 188 of the Act. However, the same has been not defined. The Guidance Note on related party transactions provides 8 parameters that can be considered for a transaction to be in 'ordinary course of business' of the said the company. However, taking into consideration the complexities of transactions, the list is not exhaustive.

The Guidance Note on related party transactions addresses another important factor - arm's length transaction. The Guidance Note has given reference to section 92C of the Income Tax Act w.r.t. the methods for determining arm's length price in relation to an international transaction or specified domestic transaction. The Guidance Note has referred to following methods: (i) Comparable uncontrolled price method, (ii) Resale price method, (iii) Cost plus method, (iv) Profit split method, (v) Transactional net margin method, (vi) Such other method as may be prescribed.

The Guidance Note on related party transactions has provided a tabular chart for the basis of determining arm's length basis for each type of transaction (as described in Section 188(1) of the Act).

The Guidance Note has addressed more than 50 issues on related party transactions. The ICSI has given its views (and not 'answer') to such pertinent issues. Such issues are in relation to related party transactions *vis-à-vis* managerial appointment, managerial remuneration, issue and transfer of shares, approval process and disclosures. At the time of dealing with related party transactions, the Company Secretaries (in employment or practice) and other professionals may come across such issues. ICSI's insight into such issues will be helpful for the readers.

The Guidance Note contains checklist of corporate secretarial records for related party transactions by private companies, unlisted public companies, listed companies. The checklist can further be refined and made customised, depending on the complexity of transactions in the group of companies.

The Guidance Note on related party transactions also provides for specimen resolutions for following approval processes:

- (1) Audit Committee's specific approval,
- (2) Audit Committee's omnibus approval,
- (3) Resolution to be passed by the board of directors at its meeting,
- (4) Resolution to be passed by the shareholders at its meeting.

Conclusion

3. The ICSI's Guidance Note on related party transactions is very helpful for the professionals in ensuring compliance of the complex provisions. The issues raised and views expressed by ICSI will assist the compliance officers, Company Secretaries and corporate law professionals in proper application of the provisions relating to related party transactions. The discussion on the SEBI Listing Regulations will be helpful for the compliance officers for listed companies and the Secretarial Auditors of respective companies.

However, there should have been discussion on section 185 of the Act (relating to 'loans to directors') in ICSI's Guidance Note on related party transactions. Though loans, guarantees and securities provided by company to its 'related party' is covered in a separate section (*i.e.*, section 185 of the Act), such transactions are with parties in which directors are interested. There are many practical issues in compliance of Section 185 of the Act (after the same has been substituted by the Companies (Amendment) Act, 2017).

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