



Related Party Transactions



CS Ranjeet Pandey - FCS, LL.B.
Former President, ICSI (2019)
Ex-VP, CSIA
Ranjeet Pandey & Associates
Company Secretaries
Tel: 09810558049, 011 – 46074119
e-mail: cs.ranjeet@gmail.com

AGENDA FOR DISCUSSION

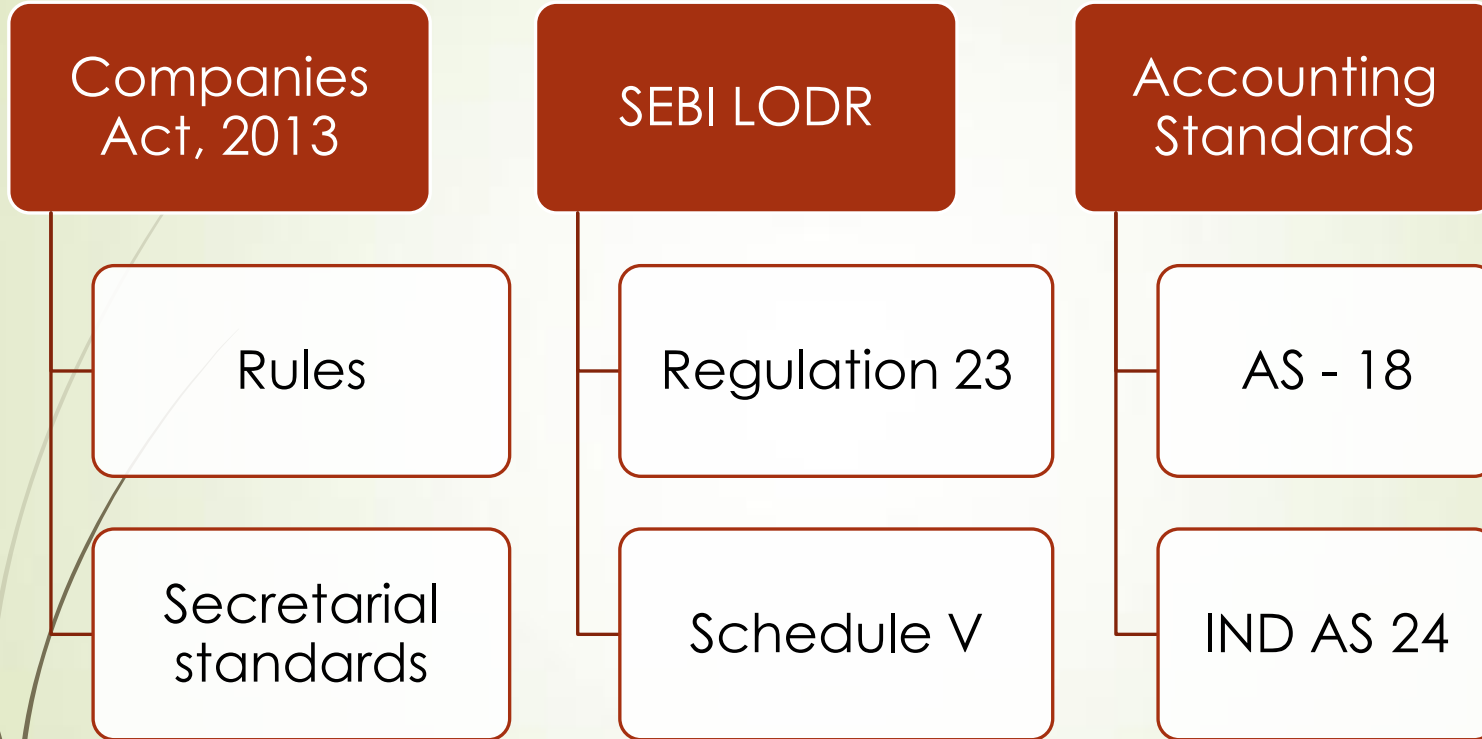
- ✓ Why to regulate RPT
- ✓ Who is Related Party, What is RPT
- ✓ Key Concepts – Arms Length, Ordinary Course of Business
- ✓ Approvals - Audit Committee, Board and Shareholders
- ✓ Disclosures
- ✓ Consequences of Default / non-compliance
- ✓ FAQs

WHY RPT IS REQUIRED TO BE REGULATED ?

Regulations ensures:

- ✓ Avoiding conflict of Interest in decision making
- ✓ Transaction with related parties should be on same terms as in case of unrelated parties - Arms Length transactions
- ✓ Transparency & Disclosures of RPT

LAW RELATING TO RPTs





Relative, Related Party & Related Party Transactions



WHO IS RELATIVE ??

Relative under S/ 2(77) readwith Rules

- Member of HUF;
- Husband and wife;
- As per Companies (Specification of Definition Details) Rules, 2014:
 - ✓ Father including Step-father;
 - ✓ Mother including Step-mother;
 - ✓ Son including Step-son;
 - ✓ Son's wife;
 - ✓ Daughter;
 - ✓ Daughter's Husband;
 - ✓ Brother including Step-brother;
 - ✓ Sister including Step-sister;

RELATED PARTY - SECTION 2(76)

Director / KMP
or relative
thereof;
(of Co./HCo.)

Firm: Director
/ Manager or
his relative is
Partner

Pvt. Co. :-
Director,
Manager or his
relative is
member or
director;

A public Co. :-
director / manager
is a director AND
holds along with
his relatives more
than 2 % of its
capital

Any body
corporate whose
board or MD or
Mgr. is
accustomed to act
- on instructions
of a director or
manager.

Any person on
whose advice,
directions, or
instructions a
director or manager
is accustomed to
act.

HCo./SCo./
Associate
Co -
SI/JVC.

Subsidiary
of a
holding
company.

RELATED PARTY – LISTING REGULATIONS

Regulation 2(1)(zb): related party means a related party as defined under:

- ❖ covered under section 2(76) of the Companies Act.
- ❖ under the applicable **Accounting Standard**.
*“Parties considered to be related if at any time during the reporting period one party has ability to **Control** the other party or exercise **SIGNIFICANT INFLUENCE** over the other party in making financial and / or operating decisions.*
- ❖ any person or entity belonging to the promoter or promoter group of the listed entity **and** holding 20% or more of shareholding

WHAT IS RELATED PARTY TRANSACTION (SECTION 188)?

Sale, purchase or supply of any goods or materials;

Leasing of property of any kind;

Availing or rendering of any services

Selling or otherwise disposing of, or buying, property of any kind;

Appointment of any agent for purchase or sale of goods, materials, services or property;

Related party's appointment to any office or place of profit in the Co, its subsidiary Co or Associate company; and

Underwriting the subscription of any securities or derivatives thereof, of the company:

RELATED PARTY TRANSACTIONS – LISTING REGULATIONS

- ❑ Regulation 2(1)(zc) of SEBI (LODR) - “related party transaction” means
 - ❑ a transfer of resources, services or obligations between a listed entity and a related party,
 - ❑ regardless of whether a price is charged and
 - ❑ transaction with a related party shall
 - include a single transaction or
 - group of transactions in a contract

RELATED PARTY TRANSACTIONS – SECTION 177

- ❑ The coverage of RPT u/s 177 is much **wider** than section 188 - financial transactions such as loan, guarantee etc. are also covered.
- ❑ All RPTs have to be approved by audit committee (sec. 177(4)(iv)]
- ❑ If Audit Committee does not approve a transaction, it shall make recommendations to the Board
- ❑ Approval not required, if RPT u/s 177 is entered between HCo. & WoS
- ❑ Materiality concept, transactions under ordinary course of business and arm's length not relevant for RPT u/s 177

RPTs – Approval related provisions

Section 188 read with Section 2(76):

- ❖ All RPTs require approval of **Audit Committee**.
- ❖ Transactions covered under section 188 *which are not at arm's length or not in the ordinary course of business*, requires **Board Approval**.
- ❖ Transaction with related parties **above prescribed limits**, *which are not at arm's length or not in the ordinary course of business* will require **Shareholder's approval by Ordinary Resolution**.
- ❖ **For Shareholders' meeting - related members can't vote on such resolutions. In case of WOS, who will vote? - Will Holding Company resolution be sufficient?**

Approvals of RPTs by Audit Committee

Approvals of various transactions:

- ❖ All related party transactions requires mandatory Prior approval as per Listing Regulations – Specific or Omnibus or ratification (within 3 months).

- ❖ **Omnibus approval** can be taken subject to conditions:
 - ❖ Lay down criteria – transactions of **repetitive nature**.
 - ❖ In the interest of the Company
 - ❖ Approval shall specify nature, period, amount, indicative price, etc.
 - ❖ If RPTs can't be foreseen – omnibus approval upto **1 Crore**.

- ❖ **Review** of omnibus approval on Quarterly basis.
- ❖ Approval shall be valid for One Year.

Approvals of RPTs by Audit Committee

Approvals of various transactions:

- ❖ Subsequent material modifications in RPT requires prior approval of audit committee (w.e.f. 01/04/2022).
- ❖ Only ID to approve RPTs (w.e.f. 01/04/2022).
- ❖ Audit Committee to define material modifications and disclose it as a part of policy on materiality.
- ❖ Transaction by subsidiary of listed entity - prior approval, if value of transaction exceeds 10% of Annual Consolidated Turnover (w.e.f. 01/04/2022).
- ❖ Transaction by subsidiary of listed entity - prior approval, if value of transaction exceeds 10% of Annual Standalone Turnover of subsidiary (w.e.f. 01/04/2023).

Approvals of RPTs (section 188 & Listing Regulations)

When Shareholders' approval will be required:

- ❖ All material RPT *or subsequent modifications* entered into with RPs – prior approval of shareholders by OR
- ❖ Transactions of sale, purchase, supply of goods or material directly or through agent amounting to 10% or more of the turnover;
- ❖ Selling or otherwise disposing of, or buying, property of any kind directly or through agents amounting to 10% or more of net worth;
- ❖ Leasing of property of any kind amounting to 10% or more of the turnover;
- ❖ Services directly or through agent – 10% or more of the turnover of the Co.;
- ❖ Place of profit - remuneration exceeding Rs. 2.5 Lakh or,
- ❖ Underwriting - Fees exceeding 1% of Net Worth.

Approvals of RPTs

When approval of Shareholders not required:

- ❖ Transactions with WOS, if accounts are consolidated.
- ❖ Transactions are not at arm's length basis
- ❖ Transactions are in Ordinary course of business.
- ❖ Concept of materiality as per Regulation 23 – if transaction exceeds **10 % of Annual Consolidated Turnover**.

Materiality, other provisions – Listing Regulations

- ❖ LE to formulate policy on **materiality** including clear threshold limit.
- ❖ Policy duly approved by Board.
- ❖ Transaction is considered material as per Regulation 23 – if transaction exceeds 10 % of Annual Consolidated Turnover (**Amended w.e.f. 01/04/2022**).
- ❖ Brand usage or royalty - if transaction exceeds 5% of Annual Consolidated Turnover.

Related Party Transactions

Q. Whether S/188 covers following transactions ??

Allotment of Shares to relative of KMP.	No
Licensing of a Brand to one of the subsidiaries.	Yes.
Corporate Guarantee for a loan taken by an Associate.	No.
Appointment of CFO and deciding the remuneration.	Appointment – No Remuneration – Yes
Receipt of Reimbursement of expenses on actual basis from a subsidiary.	No.

Ordinary Course of Business

- In common parlance, 'ordinary course of business' would include transactions which are entered into in the normal course of the business pursuant to or for promoting or in furtherance of the company's business objectives.
- Factors to be considered, while deciding "Ordinary Course of Business":
 - Whether the activity is covered in the objects clause of the MOA & in furtherance Companies business (**This is not conclusive**);
 - Whether the activity is routine for the particular business (e.g. Branding, taking premises on rent, staff training, etc.);
 - Whether the activity is repetitive/frequent;
 - Whether income earned from such activity/transaction is treated as business income in the company's books of account;
 - Whether the transactions are common in the particular industry
 - Whether there is any historical practice to conduct such activities

Arm's Length Transactions

- Explanation Section 188 (1) - '*arm's length transaction*' as a transaction between two related parties that is conducted *as if they are unrelated, so that there is no conflict of interest.*
- The *transaction as a whole* and the *entire bundle of the terms and conditions* needs to be considered for determining whether the transaction is on an arm's length basis.
- In terms of Section 92F of the Income-tax Act, 1961, "arm's length price" means a *price which is applied or proposed to be applied* in a transaction *between persons other than associated enterprises*, in uncontrolled conditions.
- Section 92C of IT Act, 1961, the arm's length price in relation to international transaction or specified domestic transactions be determined by any of the following methods:
 - comparable uncontrolled price method;
 - resale price method;
 - cost plus method;
 - Profit Split method
 - transactional net margin method;
 - Such other method as may be prescribed

Consequences

Consequences if RPTs not ratified by board / General Meeting:

- ❖ A contract entered into by the company without disclosures under 184(2) or with participation of interested director shall be **voidable** at the option of the Co.;
- ❖ The directors concerned shall **indemnify** the company against any loss incurred by it & Company can **recover losses** from director or other employee;
- ❖ A director is **disqualified** for appointment, if he has been **convicted** of the offence dealing with related party transactions under section 188 at any time during the last preceding **five** years;
- ❖ Unlisted Company, Director / employee – fine **Rs. 5 Lakh**;
- ❖ Listed Company, Director / employee –fine **Rs. 25 Lakh**.

Disclosures of RPTs

- ❖ All material Transactions – Quarterly with Compliance report on Corporate Governance.
- ❖ Policy to be placed on website and weblink on the Annual Report.
- ❖ Listed Entities shall submit within 30 days from the date of publication of financial results for the half year – disclose RPT to the stock exchanges and publish on website.
- ❖ To be disclosed in the Board Report.

Related Party Transactions

Q. ABC Pvt. Ltd. has availed services from a related party amounting to Rs. 50 crore, which is claimed to be in **ordinary course of business** and **at arm's length price**. Will the aforesaid transaction **trigger** the provisions of the Section **188**?? Further will the **disclosure** of such transaction be required as per S. 134 of the Act ??

Related Party Transactions

- R. If ABC Pvt. Ltd. proves that the transaction is in “*ordinary course of its business*” and “*on arms’ length price*” then Section 188 will not attract. However, the transaction details shall be reported in the Board Report (AOC 2) to be prepared under section 134.

Related Party Transactions

Q. ABC and Co. has some **related party transactions**. Is there a requirement of obtaining prior **approval of the Audit Committee** for such transactions? What if **ABC & Co. is listed entity** as regards the approval of Audit Committee??

Related Party Transactions

R. Every New Transaction with Related Party require prior approval of Audit Committee.

Listed Companies – Compliance of Regulations 23 of the SEBI LODR will be required – **Shareholder Approval for every material transaction.**

All RPT transaction would require approval of Audit Committee and the same will be approved by Independent Directors only.

Related Party Transactions

Q. In case of related party transactions, the interested directors or members are debarred from voting at Board meeting/general meeting. In case of ABC Ltd. there are three groups or families A, B & C as shareholders/promoters/related parties in the ratio of 50%, 25% & 15% & remaining 10% is held by some PE investors.

Where a transaction with a party related to say A is contemplated, who is debarred from voting, only A or other shareholders/promoters as well?

How would such companies carry out such business at General meeting??

Related Party Transactions

- R. Only “A” will not participate in meeting. Further, non-voting by interested members shall not apply to a Company in which 90% or more members, in number are relatives of promoter or related parties.

Related Party Transactions

Q. Section 188 requires prior approval of Board for entering into specified contracts or arrangements with related parties. Section 177(4)(iv) requires approval of **transactions of company with related party** by the Audit committee??

Whether, approval from Audit Committee is required for any transaction with related party in respect of transactions, which are covered under section 188??

Related Party Transactions

R. Wherever constitution of Audit Committee is mandatory, the RPTs should be approved by the Audit Committee.

Further, if any transaction is not a RPT u/s 188, but with related party, approval shall be required.

Related Party Transactions

Q. In a private company, which is a **subsidiary of a foreign company** under Companies Act, 1956, transaction with foreign companies were exempted. Under the Companies Act, 2013 are these exemptions still available or they are covered under RPT??

Whether the term "**Leasing of Property of any kind**" includes leasing of Equipment owned by the Company??

Related Party Transactions

- R. Transactions with foreign Companies are covered under Related Party Transactions. However, 2(76)(viii) will not be applicable for Private Company in respect of section 188.

- R. Yes. "**Leasing of Property of any kind**" includes leasing of Equipment owned by the Company.

Related Party Transactions

Q. A private company has **two shareholders** and these shareholders are the **only two directors** of the Company. Whether **Board resolution** can be passed for **remuneration** when there are only two directors and both are **interested and related party** ?? Whether provisions of **Sec. 188** will be hit?

There is one opinion that in such cases, the **resolution for remuneration should be passed in shareholders meeting**. But again there are **only two shareholders and they are the directors**. **Interested shareholders will not** be in a position to **vote for the resolution**. So what would be way out?

Related Party Transactions

R. Payment of remuneration to directors not covered under the definition of RPTs u/s 2(76), and therefore, section 188 will not be applicable on payment of remuneration.

However, approval of members will be required for payment of remuneration to directors under section 196. The same is exempted for private limited companies vide exemption notification dated 05.06.2015 as on date.

CS Ranjeet Pandey
Former President, ICSI (2019)
Ranjeet Pandey & Associates
Practising Company Secretary
09810558049, 011 – 46074119
cs.ranjeet@gmail.com



Thank you