

Related Party Transactions under Companies Act, 2013

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**This presentation aims
to analyze RPT provisions to build
strategies & find solutions to
implement the same.**

Rationale

Covered in Part 3 of Chapter V of 'Report on Company Law' given by Expert Committee on Company Law chaired by Dr. JJ Irani:

- "Directors have the duty not to place themselves in a position where their fiduciary duties towards the company conflict with their personal interests. And in case it happens, directors have the duty to prefer to protect the interests of the company."
- In case of doing away with the Government approval regime and replacing the same with shareholders approval regime, international practices and suitability for future Indian market were considered.
- General restrictions are placed on loan to director or relative.
- Holding office or place of profit by relative of director is allowed subject to approval of members.

- International Transfer pricing regulations
- Domestic Transfer pricing regulations
- Accounting standard AS 18 – disclosure regime
- Tax Audit Report – Audit of related party transactions

Reactionary approach



What Business Demands.



M.R.M. Co.

956 (Abtak Chhappan)



v/s



(Dobara Sath Tera) 201

M.R.M. Co.

The Companies Act, 1956

- No definition of related party however parties were specified in S 297
- S 299 - requiring directors to disclose their interests
- S 300 - formation of disinterested quorum in the Board was limited only to Public Company
- S. 297 dealt with sale, purchase & supply of goods & services and underwriting the subscription of shares.
- Property transactions including leasing were out of scope
- Central Government approval route was prescribed for all companies having paid-up share capital more than Rs. 1 Crore.
- The exemption was provided for purchase/ sale of goods/ services for cash at prevailing market prices.
- Transaction between two Public Companies was exempted from S 297.

The Companies Act, 2013

- Definition of Related Party added
- Applicable to all types of companies
- General disclosure of interest is to be made by a director.
- Additionally he has to disclose his specific interest in the Board meeting or after the Board meeting and shall not participate in the discussion.
- Transactions of immovable properties are also covered.
- Concept of Central Government approval dispensed with.
- Prior approval from Audit Committee/ Board/ Shareholders is required.
- The exemption is provided for transactions entered in the ordinary course of business and at arm's length basis.
- Pre & Post transaction disclosures prescribed

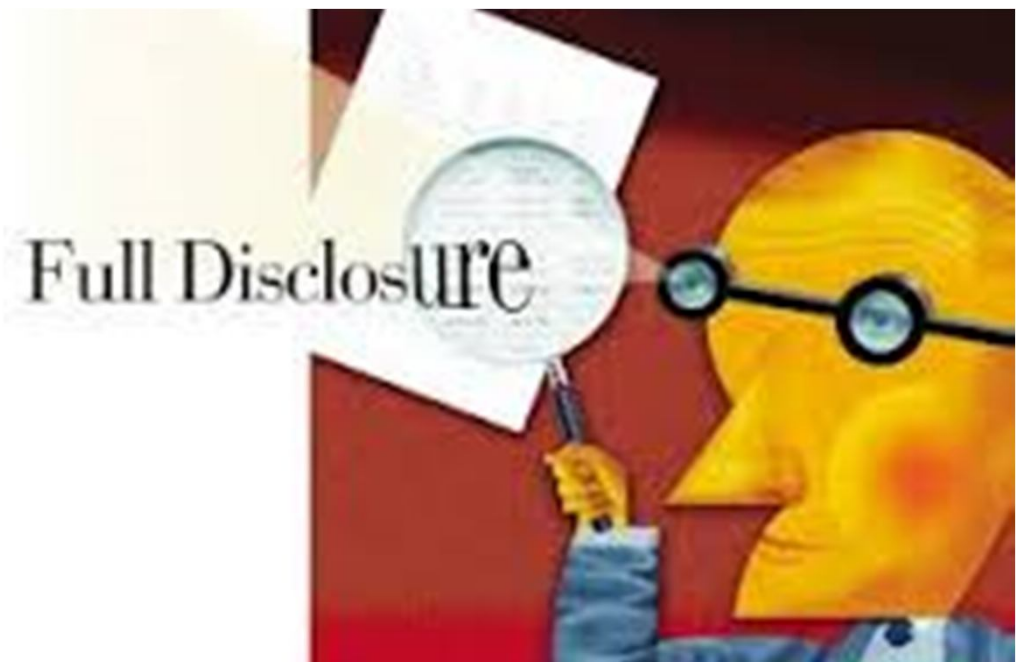
Director's interest in transactions



Board to have Disinterested Quorum

- Section 174 provides for a quorum for Board meeting
- For entering into any contract/ arrangement in which Director is directly or indirectly concerned or interested, formation of a disinterested quorum is essential.
- Test of dis-interest provided in section 184 (2)
- The interested Director has to disclose his interest.
- All transactions including those specified in Section 188 needs to be approved by Disinterested Quorum.
- Proposed exemption for private company – allowing interested director to participate - will this exemption make him disinterested director?

Disclosure of Interest by a Director-184



Section 184 enforced from 1.4.14

- **General Disclosure**

- **Sub section (1) requires director to disclose his concern or interest**

- in the first board meeting - where he participates
 - & thereafter on annual basis- in first board meeting
 - periodically disclose changes- in first board meeting after change.
 - Disclosure to be made vide Form MBP-1.
 - Disclose of interest in a company or body corporate, firm or other association of individuals including shareholding details is required.
 - Its director duty to ensure that his disclosure is noted in the Board meeting

Section 184 (1)

• **General Disclosure**

- Definition of related party & rule 3 of Companies (Specification of definitions details) Rules, 2014, identifies interest through KMP of the Company or its holding company. Hence KMP would also require to disclose his interest.
- Board resolution taking note of disclosure of director's interest & shareholding is required to be filed in form MGT 14 within 30 days including resolutions noting changes.
- **Exemption from filing these resolutions by private company is proposed**

Specific Disclosure & action

- Sub section (2) of section 184 further requires director to disclose his direct or indirect concern or interest in **any proposed contract or arrangement** to be entered into;
 - with a body corporate in which he individually or with other directors holds more than 2% shareholding
 - or as a promoter, manager or CEO of that body corporate
 - with a firm or other entity in which such director is a partner, owner or member
- Further he is not entitled to participate in the discussion during the Board meeting
- If he becomes interested subsequently he has to disclose the same to the Board immediately or at the next board meeting

Voidable Contracts – S 184

- If contract or arrangement is entered without undertaking the compliance of S 184 (2) then the same is voidable at the option of the Company.
- Company means Shareholders?
- Is this a route for approving the transactions by the shareholders, when Board does not have disinterested quorum?

Duties of directors

- Director has following two important duties among others specified in Section 166:
 - He shall not involve in a situation in which he may have a direct or indirect interest that conflicts, or possibly may conflict, with the interest of the company.
 - He shall not achieve or attempt to achieve any undue gain or advantage either to himself or to his relatives, partners, or associates
 - if such director is found guilty of making any undue gain, he shall be liable to pay an amount equal to that gain to the company.

Related party transactions

**"Jimbo Dear,
we have to be
extremely careful in
our relationship....**

**because of us our
mam's should not
become related
parties"**



Company A



SALE



PURCHASE



SUPPLY



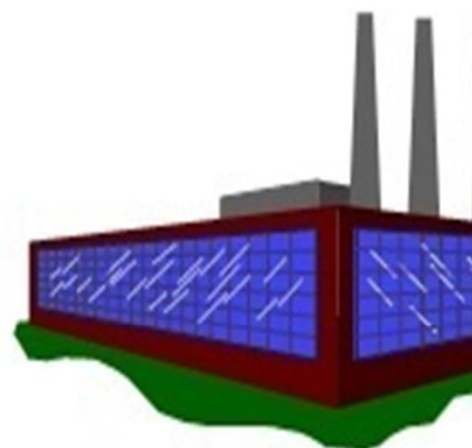
SERVICES



LEASING



Related party



M.R.M. Co.

Two Important Test



Wear a company specs



Whether party is related to the
Company?

Whether there is a contract or
arrangement?

Applicable legal provisions

Section 184, 188 of the Companies Act, 2013
enforced with effect from 01.04.2014

Rule 3 & 4 of Companies (Specification of
definitions details) Rules, 2014 & Companies
(Specification of definitions details) Amendment
Rules, 2014

1st & 5th Removal of Difficulties Order

Rule 15 & 16 of Companies (Meetings of Board and
its Powers) Rules, 2014

General Circular No. 30/2014 dated 17.07.2014

Highlights

Applies to both Public & Private

No monetary exemptions

Most of the transactions are covered

Related parties through company are also added

Disinterested Quorum required for approving RPT at Board Meeting

Interested member cannot vote at General Meeting

Exemption through arms length basis & in the ordinary course of business

No central Government approval route available

No escape route available to the Company

MCA provided certain explanations and proposed some procedural exemptions to private co – need base amendments!

Who is a 'Related Party'?

RP through Director/ Manager

S 2 (76)

- With reference to a Company
 - Director himself
 - Directors relatives
 - Firm in which director/ manager or his relative is a partner
 - Private Company in which director/ manager is member or director (relative not included)
 - Public Company in which director/ manager is a director **and** he or together with his relatives holds more than 2% of the paid up capital
 - Any Body corporate whose Board/MD/ MGR is accustomed to act in accordance with the advice, directions or instructions of a director or manager. (excludes professional capacity)

RP through Company

- Its Holding
- Its subsidiary
- Its Associate
- Fellow subsidiary
- a director (other than an independent director) or KMP of the holding of such company or their relatives with reference to a company
(Proposed to be exempted to private)

RP through KMP/ Others

- KMP himself
- KMP's relatives
- Any person on whose advice, directions or instructions a director or manager of the Company is accustomed to act. (This excludes professional capacity)

Meaning of term 'Relative'

Relative means:-

- Members of HUF,
- Husband and wife,
- Father, Mother, Son, Brother, Sister including such step relations,
- Son's wife, Daughter, Daughter's husband.

Relatives who are not covered under CA, 2013:-

- Ascendants through father and mother
- Decedents through son, daughter
- Spouses of brother and sister

Which transactions are covered?

Who has to undertake compliance?

- (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; and
- (g) underwriting the subscription of any securities or derivatives thereof, of the company

Exempted Transactions



Exempted Transactions – S 188

Transactions entered into by the company in **its ordinary course of business** with related parties at **arm's length basis**

No approval required in Wholly owned subsidiary for transaction with its holding if special resolution is passed by holding company

Transaction with Public company in which director is only a director

Transaction with Public company in which director is a director & holds along with his relatives, less than 2% of its paid up share capital

Transaction with Holding Body Corporate

Transaction with fellow subsidiary if holding is BC & there are no common directors

Transactions of private limited company with its holding, subsidiary, fellow subsidiary, associate company - (Proposed)

Exempted Transactions – S 184 (2)

- Transaction with self or relative?
- Transaction with RP of Company / KMP/ Manager (director not interested in any manner)
- Transaction with BC in which director is a director (no holding or holding less than 2%)
- Transaction with BC where director/s is/are holding less than 2% shares
- Director is a director in another BC & holding more than 2% shares as nominee. Wording “shareholding” is used and not “member”

Ordinary course of Business

- 3rd Proviso to S 188 (1) provides that transactions entered by the company in **its ordinary course of business** with related parties at **arm's length basis** need not comply with approval requirements.
- Expression "**in the ordinary course of business**" means in the usual course & routine of business, customs and practices of a certain business.
- Ordinary course should not be confused with the Ordinary requirements to carry out business activity.
- Document to be referred to justify ordinary course of Business:
 - Scope provided by main object(s).
 - Standard Business Agreements
 - Activity of the Company

What is arm's length - how to measure & justify it?

- S 188 does not prescribe any methodology to calculate price **arm's length basis**
- This a backdoor entry of TP
- Section 2(h) of Central Excise Act, 1944, defines "**sale**" and "**purchase**", with their grammatical variations and cognate expressions, mean any transfer of the possession of goods by one person to another **in the ordinary course of trade or business** for cash or deferred payment or other valuable consideration.

- Section 92F(ii) of the Income Tax Act, 1961, defines the **Arm's length price** as a price which is applied or proposed to be applied in a transaction between persons other than associated enterprises, in uncontrolled conditions.
- The concept of an arm's length transaction ensures that both parties in the deal are acting in their own self interest and are not subject to any pressure or compulsion from the other party.
- Transaction is made as if both parties are unrelated, so that there is no conflict of interest.
- Price & terms should not be favourable.

Recourse could be taken to the Income Tax Act, 1961 which forms the core of Commercial Legislations in India.

Methods of calculating Arm's length price are prescribed in S. 92C the said Act.

The following are the methods prescribed:

- comparable uncontrolled price method
- resale price method
- cost plus method
- profit split method
- transactional net margin method
- such other method as may be prescribed by the CBDT.

The most appropriate method is to be applied, for determination of arm's length price.

- Following documents would be useful for Identification of Arms' length price
 - Third party quotations
 - Valuation report
 - Tender / bid documents
 - Documents related to negotiations
 - Standard rate contracts
 - Commercial and economic business models
- What benchmarking could be used – GAT Valuation, Legal restrictions
- Safe Harbor Rules under IT – Software 20% margin

Office or place of profit

What is 'Office or place of profit'

- Means any office or place—

Where such office or place is held by a director:

- he receives from the company **anything** by way of remuneration **over and above** remuneration to which he is entitled as director,
- by way of salary, fee, commission, perquisites, any rent-free accommodation, or **otherwise**.

Where such office or place is held by an individual other than a director (relative) or by any firm, private company or other body corporate:

- it receives from the company **anything** by way of remuneration, salary, fee, commission, perquisites, any rent-free accommodation, or **otherwise**.
[Explanation (a) to S. 188 (1)]

Compliances

- Office or place of profit includes office or place of profit held in the Company.
- Contract or arrangement entered with its associate or subsidiary company for related party's appointment to any office or place of profit.
- Prior Board resolution for monthly remuneration not exceeding Rs. 2,50,000/- & beyond this prior special resolution.
- Pre and post disclosures required in both cases.
- The remuneration drawn by director by holding office or place of profit forms a part of managerial remuneration under S. 197 unless drawn in professional capacity. [S. 197 (4)]

Compliances for RPT



Compliances

Board Approval

- Prior Board Approval is required for entering any transactions with related parties. Consent of the Board at a meeting is required, where the Interested Director shall not be present during the discussion.
- A disinterested quorum is required at such meeting.

Audit Committee

- Terms of reference of Audit Committee contain a clause of approval & modification to related party transactions already entered into by the Company.
- Thus, if the Company has an Audit Committee, then terms of reference should specify its exact scope towards this function

Agenda of Board meeting to contain following

- Name of RP & nature of relationship
- nature and duration, particulars of contract/arrangement
- material terms, value of contract/arrangement
- advance paid/ received
- manner of deciding pricing & other terms included in contract & not considered as part of contract
- details of factors considered along with rationale for factors not considered and other relevant information.

RPT Shareholders Approval - Special Resolution

Transaction	Limit
Paid Up Capital of Company exceeds Rs 10 Cr	All transactions with RP
Sale, purchase or supply of any goods or materials directly or through appointment of agents	Exceeding 25% Turnover.
Selling or otherwise disposing of, or buying, property of any kind;	Exceeding 10% of Net Worth
Leasing of property	Exceeding 10% of the net worth or 10% of turnover

RPT Shareholders Approval - Special Resolution

Transaction	Limit
Availing or rendering of any services directly or through appointment of agents	Exceeding 10% of the net worth.
Appointment to any office or place of profit in the company, its subsidiary company or associate company at a monthly remuneration	Exceeding Rs. 2,50,000/-
Remuneration for underwriting the subscription of any securities or derivatives thereof of the company	Exceeding 1% of the net worth.

- Prior approval of the Company by a special resolution
- Only Interested Related Party member will not vote – Others Can – (Explanation provided by General Circular 30/2014)
- **Explanatory statement** annexed to notice of general meeting should provide for name of related party, name of director or KMP who is related, nature of relationship, material terms, value & any other important information to enable members to take decision.
- Turnover or Net Worth shall be on the basis of the Audited Financial Statement of the preceding financial year & to be calculated on the basis of definitions provided in the Act .

Voidable Transactions 188 (3)

- If contracts is entered by a Director or any employee of the company with related party
- Without obtaining consent of the Board or approval of members
- & if Board or GM is not ratifying it within 3 months
- Then such contract is voidable at the option of the Board
- Such interested director or a director who has authorized such contract should indemnify the company against any loss incurred by the Company.
- Company can proceed against director or employee for recovery of a loss.

Non-cash transactions with Directors

- Section 192 is enforced from 12.09.2013.
- Prior approval shareholders is required for:
 - Any arrangement/ transaction by Company for acquisition of assets for consideration other than cash from
 - Its director or
 - Director of its holding, subsidiary or associate company or
 - A **person connected with him**
 - Any arrangement/ transaction where such Director or such connected person is to acquire assets from the company.

- The notice of general meeting shall include the particulars of the arrangement, the value of the assets involved such should be calculated by a registered valuer.
- Transaction in contravention of these provisions shall be voidable at the instance of the company unless;
 - the restitution of consideration is no longer possible and the company is indemnified for loss by some other person or
 - any rights are acquired bona fide for value and without notice of the contravention of these provisions by any other person.

Related party transactions in OPC



One Person Company



- Where OPC enters into a contract with the sole member who is also the director of the company:
 - The contract shall be in writing or
 - The terms of the contract or offer are contained in a memorandum or
 - The terms are recorded in the minutes of the first meeting of the Board of Directors of the company held next after entering into contract. [S. 193]
- This section shall not apply to contracts entered into in the ordinary course of business.
- If contract is entered through minutes, the details of the same are to be filed within 15 days of approval by the Board.

Critical Issues



Contracts subsisting on 01.04.2014

- Clarification provided vide General Circular No. 30/2014
- Compliance under section 188 will not be required for continuing contracts on the same terms & conditions for its unexpired period - explanation provided.
- Approval obtained from CG under section 297 will continue till its unexpired period.
- Section 188 will hit if there is;
 - Variation in the terms & conditions
 - Renewal of the contract or arrangement

Critical Issues

In light of proposed exemption to private limited company-
Can a director be treated as disinterested to vote?

Director of private limited company (on getting exemption) participating in discussion and may be voting on a resolution in which he is interested, whether will be able to perform his duties casted by section 166 (4)?

Whether continuing transactions not covered under section 297 can continue now in light of wording of circular 30/2014 "*after making necessary compliances under Section 297*"? Or do they need approval now under section 188 because of clarification?

- Whether provisions of section 188 apply to following?
 - Remuneration to Directors
 - Transaction relating to shares (sale, purchase)
 - Allotment of shares
 - Granting of loans to or making of investments
- Can shareholders approve the contracts which Board can not approve on account of non availability of dis-interested quorum?
- In case of a director of holding company appointed to office of profit at subsidiary or associate company, then whether holding has to do the compliance?
- In above situation what compliance subsidiary has to do?
- In above situation what compliance associate has to do?
- Whether WOS needs to comply provisions of S 188 for contracts with its Holding, if contract is below special resolution threshold limits?

RPT Disclosures in documents & returns

disclosure in the prospectus

RPT entered during the last 5 FYs immediately preceding the issue of prospectus as under -

- all transactions with respect to giving of loans or, guarantees, providing securities in connection with loans made, or investments made ;
- all other transactions which are material to the issuer company or the related party, or any transactions that are unusual in their nature or conditions, involving goods, services, or tangible or intangible assets, to which the issuer company or any of its parent companies was a party:

RPT entered prior to 1.4.2014 should be disclosed as per provisions old sections under Companies Act, 1956.

Disclosure in the private placement offer letter in Form PAS-4:

RPT entered during the last 3 FYs immediately preceding the year of circulation of offer letter including loans made or, guarantees given or securities provided [Point 3 (iv) of Form PAS-4]

Information about RPTs to be disclosed in the Board's report Form AOC-2

Disclosures about RPT including arm's length transactions

Disclosure has to be made for exempted transactions also

Form AOC-4 [Filing of financial statements with registrar]

Segment D contains detailed disclosures about RPT including arm's length transactions.

Statement to be annexed to notice under Section 102

Every resolution placed before the members for approval should state the interest of director in the said transaction.

Returns & Registers



Return

- Submission of Form MGT-14 after passing special resolution together with Extract of Resolution and Explanatory Statement.
- No need to file copy of contract

Register of Disclosures

Register of Bodies etc, in which directors are interested as per section 184 (1) is required to be maintained in **MBP-4** which contains the following details:

- Names of the companies , body corporate, firms , association of individuals
- Name of the interested Director
- Nature of interest or concern or change in interest or concern
- Date on which interest or concern arose or change

Entry shall be made only if director together with any other director holds more than 2% of the paid up capital of the other company or body corporate. (Proviso to Rule 16 (1) (a))

Register of RPT

Register of Related Party disclosures and transactions is required to be maintained in **MBP-4** which contains the following details:

- Details of the party with whom the transactions is proposed
- The names of interested directors and nature of interest
- Principal terms
- Whether on arm's length basis
- Date of Board Approval including the voting details for such approval
- Nature of transaction as per Section 188 (1) (a) to (g)
- Amount of contract
- Date of shareholders' approval, if any

Entries in the Register shall be made

- at the time of arising of cause to make a entry
- in chronological order
- authenticated by CS/Any person authorised by Board.

Entries to be made :

- For sale purchase or supply of goods and material or services the transactions where the value exceeds Rs. 5 Lacs during a financial year. (Sec 189 (5))
- For all other transactions without any monetary limit
- All entries of non-cash transactions referred to under Section 192

Register of Disclosure & RPT

- Register to be kept at RO in physical or in electronic form
- Preserved permanently
- In the custody of CS/ Any person authorised by Board.
- Register shall be open for inspection to the member & extracts to be provided within 7 days of request on payment of fees.
- This register needs to be produced at the commencement of AGM & remain open during the meeting.

Non Compliance



Non-compliance of Section 188 :

- Any director or any other employee of a company, who had entered into or authorized the contract or arrangement in contravention - fine Rs.25 Thousand- Rs. 5 Lacs
- For director/ employee of listed company: in addition to the above penalty, he shall be punishable with imprisonment up to 1 year.
- Conviction for an offence under section 188 at any time during preceding 5 years is a disqualification for appointment as director & it leads to **vacation** of office.

Non-compliance of Section 184 :

- Director shall be liable for imprisonment for 1 year or with fine Rs.50 Thousand -Rs.1 Lacs or with both.
- Office of the director shall become vacant if
 - He acts in contravention of section 184 relating to contracts or arrangements in which he is interested i.e. failure to disclose his interest or participation in the meeting in which such contract is to be discussed.

Non-compliance of Section 189 regarding maintenance of register-

Director shall be liable for penalty of Rs. 25 Thousand

Non-compliance of Section 166 regarding duties of Directors –

Director shall be liable for fine of Rs. 1 Lacs- Rs. 5 Lacs

Non-compliance of other provisions and rules where no specific penalty is provided: Penalty under Section 450

For Company- Fine up to Rs. 10 Thousand

For Officer in default- Fine up to Rs. 10 Thousand

For continuing offence- Fine of Rs. 1 Thousand per day

Proposed exemptions to private limited company



• MCA has placed on website draft notification pursuant to powers conferred by clauses (a) and (b) of subsection (1) of section 462 of the Companies Act, 2013 proposing to grant exemption to private limited companies.

• MCA has laid the draft notification u/s 462 for Private Companies with some changes before parliament on 14th July, 2014.

tion	Proposed exemption tabled before the Parliament	Comment
-clause (viii) of use (76) of section 2 definition of related ty]	<p>Shall not apply with respect to section 188.</p> <p>“related party”, with reference to a company, means—</p> <p>(viii) any company which is—</p> <p>(A) a holding, subsidiary or an associate company of such company; or</p> <p>(B) a subsidiary of a holding company to which it is also a subsidiary</p>	<p>These are not related parties in private company for the purpose of Section 188</p>

Section	Proposed exemption tabled before the Parliament	Comment
<p>Clause (g) of sub-section (1) of section 117 [Filing of Form MGT-14 for exercise of the powers of the Board]</p>	<p>Shall not apply</p>	<p>MGT- 14 is required to be filed only for resolutions passed under section 117</p> <p>Not required for Board actions specified in section 179(3) and rules</p> <p>i.e. Board resolutions for making calls, issue of securities, buyback of securities, granting loans, making investments, approving financial statements, appointment of internal auditor, statutory auditor, inviting or acceptance of public deposits etc</p>

tion	Proposed exemption tabled before the Parliament	Comment
<p>ction 184(2) disclosure of interest d non-participation the meeting by an interested director]</p>	<p>Shall apply with the exception that the interested director may participate in such meeting after disclosure of his interest.</p>	<p>Interested Director after making disclosure, will be counted for the purpose of disinterested quorum</p> <p>Wording creates a doubt as to whether only participation is permitted or whether such interested director can also vote</p>

Section	Proposed exemption tabled before the Parliament	Comment
<p>second proviso to section 188 (1) [Interested party not vote during the meeting]</p>	<p>Shall not apply.</p>	<p>A member who is related party, may vote for passing such special resolution approving the contract or arrangement in general meeting.</p>

**ANY
QUESTIONS?**



Thank You

Makarand Lele's Knowledge Sharing Initiative

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