

An Analysis of Provisions of Related Party Transactions under Companies Act, 2013

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Abstract

Section 188 of the Companies Act, 2013 talks about the approval required in order to enter into related party transactions. The section provides for the various transactions which cannot be entered into by the company without the consent of the Board of Directors. Meaning thereby unless the Board of Directors have given their consent by way of a resolution at a meeting of the Board, the company cannot enter into the prescribed transactions. But by Companies Amendment Act 2015 it is liberalized and no special resolution required. Omnibus approval will be granted by audit committee for all kind of related party transactions than ordinary resolution will be passed by the board of directors for the validity of the related party transactions of a Company. In this article, the provision of related party transaction is discussed.

Keywords: Related Party, Transaction, Section 188, Holding Company, Arm's length basis

Introduction

The introduction of Companies Act, 2013 has brought out a new phase to the corporate sector. To make Corporate Law more effective much reliance is placed on the disclosure. There are number of sections which places reliance on disclosure norms, one of such section is section 188 relating to 'Related Party transaction'. In Companies Act 1956, section 295 to 301 deals with the related party transactions but in companies Act 2013 all the section are summarized in one section i.e. Section 188. Clause 49 of the listing agreement and Rule 15(3) of the Companies (Meeting of Board and Its Powers) Rules 2014 are also applicable for regulating the Related Party Transactions. Ministry of Corporate Affairs has played very appreciable role by issuing to two times notification for amending in Rule 15 of the Companies (Meeting of Board and Its Powers) Rules 2014 and it can be aspect for the future also that MCA will make required changed in the provision for removing practical difficulties in the existing provisions.

Definition of Related Party under Companies Act 2013

The Companies Act 2013, for the first time, has introduced a definition for related party, and has redefined the term "relative", to be read with the Companies (Specification of definitions details) Rules, 2014. Unlike the amended Clause 49 of the listing agreement, which defines a related party using both, rule and principal-based approach, the companies Act 2013 has used only a rule-based approach. The 2013 Act has

defined the following parties, as listed below, as a related party, in the context of a company¹

Section 2 (76) of Companies Act 2013, defines 'Related Party' as –

“related party”, with reference to a company, means-

- 1) A director or his relative;
- 2) A key managerial personnel or his relative;
- 3) A firm, in which a director, manager or his relative is a partner;
- 4) A private company in which a director or manager is a member or director;
- 5) A public company in which a director or manager is a director or holds along with his relatives, more than two per cent. of its paid-up share capital;
- 6) Anybody 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;
- 7) Any person on whose advice, directions or instructions a director or manager is accustomed to act.”²

Scope of Related Party Transactions

“Related Party Transaction” have the meaning as defined under Regulation 2(1)(zc) of the Securities and Exchange

¹ Grnat Thornton (2014). The Companies Act 2013 Deciphering the term “related parties” under the Companies Act, 2013 and Clause 49 of the listing agreement

² Section 2(76) of the Companies Act 2013

Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 as means transfer of resources, services or obligations between a listed entity and a related party, regardless of whether price is charged and a transaction with a related party shall be construed to include a single transaction or a group of transactions in a contract, including, sale, purchase or supply of any goods or materials; selling or otherwise disposing of, or buying, property of any kind; leasing of property of any kind; availing or rendering of any services; appointment of any agent for purchase or sale of goods, materials, services or property; appointment to any office or place of profit in the company; underwriting the subscription of any securities or derivatives thereof, of the company.³

Section 188 of the Companies Act 2013 deals with the provisions relating to "Related Party Transactions". There are a prescribed list of transactions covered under the Companies Act 2013, which may require board/member's approval by way of a *special resolution*, where such transactions are not in the ordinary course of business and/ or carried out at other than arm's length basis".⁴

Related Party Transactions are the transactions between "a Company and its related party, relating to:-

- 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."⁵

It is to be noted that the proviso to the Section 188 provides that a company, whose *paid up capital* is more than Rupees Ten Crore⁶ or is proposed to enter into transactions exceeding such sums as prescribed under Rule 15 of the Companies (Meetings of Board and its Powers) Rules 2014,⁷ cannot enter into the transactions, except with the previous approval of shareholders by way of Special resolution. The transactions, which require prior approval of Shareholders by way of Special Resolution are:-

- A. With respect to the sub-section (1) of Section 188, the following contracts or arrangements as per their respective limits⁸:-
 - 1) Any Sale, purchase or supply of goods or materials directly or through any agents amount of which exceeds twenty five percent of the annual turnover of the Company;
 - 2) Selling or otherwise disposing of, or buying, property of any kind directly or through the agent amount of which exceeds ten percent of net worth of the company;
 - 3) Any leasing of property which amounts ten percent or more of the turnover of the company;
 - 4) Availing or rendering of any services directly or through the agent amount of which exceeds ten percent of the net worth of the company;
- B. Appointment to any office or place of profit in the company, its subsidiary company or associate company at a monthly remuneration exceeding Rupees Two Lakh Fifty Thousand⁹;
- C. The remuneration for underwriting the subscription of securities or derivatives thereof of the company exceeding one percent of the net worth of the company¹⁰.

Explanation (2) of Rule 15 of the Companies (Meetings of Board and its Powers) Rules, 2014 provides that, in case of wholly owned subsidiary, the special resolution passed by the holding company for entering into the transactions between the wholly owned subsidiary and the holding company shall be sufficient.¹¹

Explanation (3) of Rule 15 of the Companies (Meetings of Board and its Powers) Rules, 2014 provides that the explanatory statement which is required to be annexed to the notice of General Meeting shall contain the following viz. name of the related party, name of the director or key managerial personnel interested in such transaction, nature of relationship, material value or monetary terms attached to such transaction or any other information which is necessary or important for the members for taking the decision on proposed resolution respectively.¹²

Rule 15(3) of the Companies (Meeting of Board and Its Powers) Rules 2014: Amendment in August 2014

Ministry of Corporate Affairs by notification dated 14th August 2014 substituted Rule 15(3) of the Companies (Meeting of Board and Its Powers) Rules 2014 by Rule

³ Tata Metaliks Limited. Policy on Related Party Transaction(s). Access from <http://www.tatametaliks.com/corporate/pdf/rpt-policy.pdf>

⁴Section 188 (1) of the Companies Act 2013

⁵Section 188 (1) of the Companies Act 2013

⁶Rule 15(3) (i) of the Companies (Meetings of Board and its Powers) Rules, 2014

⁷<http://blog.bassbiz.in/2014/05/monetarylimitsundercompaniesact2013>

⁸Rule 15(3) (ii) (a) of the Companies (Meetings of Board and its Powers) Rules, 2014. Access from- http://www.mca.gov.in/Ministry/pdf/NCARules_Chapter12.pdf

⁹Rule 15(3) (ii) (b) of the Companies (Meetings of Board and its Powers) Rules, 2014.

¹⁰Rule 15(3) (ii) (c) of the Companies (Meetings of Board and its Powers) Rules, 2014.

¹¹Explanation (2) of Rule 15 of the Companies (Meetings of Board and its Powers) Rules, 2014

¹²Explanation (3) of Rule 15 of the Companies (Meetings of Board and its Powers) Rules, 2014

15(3) by amending in the 'grounds of approval requirement' for Related Party Transactions. Before the amendment approval was required as according to the *paid up capital of company* if it was more than ten crore paid up capital but this provision was unnecessary burden was imposed over the small companies. To keep into mind Ministry of Corporate Affairs prescribed the amendment where companies paid up capital is not considered as 'grounds for approval requirement' but companies *turn over* is recognized for the requirement of approval. In addition with the amendment in grounds of approval requirement the percentage limit of turnover is also reduced. According to the amended Rule 15(3) of the Companies (Meeting of Board and Its Powers) Rules 2014, except with the prior approval of the company by a special resolution, a company shall not enter into a transaction or transactions, where the transaction or transactions to be entered into¹³,—

- a) as contracts or arrangements with respect to clauses (a) to (e) of sub-section (1) of section 188, with criteria as mentioned below –
- i. Sale, purchase or supply of any goods or materials, directly or through appointment of agent, exceeding **ten per cent.** of the *turnover of the company* or rupees *one hundred crore*, whichever is lower, as mentioned in clause (a) and clause (e) respectively of sub-section (1) of section 188;
 - ii. Selling or otherwise disposing of or buying property of any kind, directly or through appointment of agent, *exceeding ten per cent.* of net worth of the company or rupees one hundred crore, whichever is lower, as mentioned in clause (b) and clause (e) respectively of sub-section (1) of section 188;
 - iii. Leasing of property of any kind exceeding ten per cent. of the net worth of the company or *ten percent.* of turnover of the company or rupees *one hundred crore*, whichever is lower, as mentioned in clause (c) of sub-section (1) of section 188;
 - iv. Availing or rendering of any services, directly or through appointment of agent, exceeding *ten percent of the turnover* of the company or rupees *fifty crore*, whichever is lower, as mentioned in clause (d) and clause (e) respectively of sub-section (1) of section 188;

Explanation- It is hereby clarified that the limits specified in sub-clauses (i) to (iv) shall apply for transaction or transactions to be entered into either individually or taken together with the previous transactions during a financial year.

¹³ Rule 2 of Notification of Ministry of Corporate Affairs dated 14th August 2014. Access from - http://www.mca.gov.in/Ministry/pdf/NCA_Rules_16082014.pdf

- b) Is for appointment to any office or place of profit in the company, its subsidiary company or associate company at a monthly remuneration exceeding *two and half lakh rupees* as mentioned in clause (f) of subsection (1) of section 188; or
- c) Is for remuneration for underwriting the subscription of any securities or derivatives thereof, of the company exceeding one per cent. of the net worth as mentioned in clause (g) of sub-section (1) of section 188.

The Turnover or Net Worth referred in the above sub-rules shall be computed on the basis of the Audited Financial Statement of the preceding Financial year. In case of a wholly owned subsidiary, the special resolution passed by the holding company shall be sufficient for the purpose of entering into the transactions between the wholly owned subsidiary and the holding company.¹⁴

Omnibus approval for related party transactions on annual basis: By the notification dated 14th December 2015, Ministry of Corporate Affairs¹⁵ -

Ministry of Corporate Affairs notified about omnibus approval¹⁶ for related party transaction on 14th Dec. 2015. According to the notification, all related party transactions shall require approval of the Audit Committee and the Audit Committee may make omnibus approval for related party transactions proposed to be entered into by the company subject to the following conditions, namely:-

The Audit Committee shall, after obtaining approval of the Board of Directors, specify the criteria for making the omnibus approval which shall include the following, namely:-

- a. maximum value of the transactions, in aggregate, which can be allowed under the omnibus route in a year;
- b. the maximum value per transaction which can be allowed;
- c. extent and manner of disclosures to be made to the Audit Committee at the time of seeking omnibus approval;
- d. review, at such intervals as the Audit Committee may deem fit, related party transaction entered into by the company pursuant to each of the omnibus approval made;
- e. transactions which cannot be subject to the omnibus approval by the Audit Committee.

¹⁴ Rule 2(3) Explanation of Notification of Ministry of Corporate Affairs dated 14th August 2014. Access from - http://www.mca.gov.in/Ministry/pdf/NCA_Rules_16082014.pdf

¹⁵ Notification of Ministry of Corporate Affairs dated 14th Dec 2015. Access from http://www.mca.gov.in/Ministry/pdf/Chapter12_Rules_19032015.pdf

¹⁶ "Omnibus Approval" shall mean a blanket pre activity approval by the Audit Committee subject to compliance of the conditions as laid in this Policy. Access from <http://www.forbes.co.in/Files/20141103110759ForbesRelatedPartyPolicy.pdf>

The Audit Committee shall consider the following factors while specifying the criteria for making omnibus approval, namely (a) repetitiveness of the transactions (in past or in future); (b) justification for the need of omnibus approval. The Audit Committee shall satisfy itself on the need for omnibus approval for transactions of repetitive nature and that such approval is in the interest of the company. The omnibus approval shall contain or indicate the name of the related parties; nature and duration of the transaction; maximum amount of transaction that can be entered into; the indicative base price or current contracted price and the formula for variation in the price, if any; and any other information relevant or important for the Audit Committee to take a decision on the proposed transaction:

Provided that where the need for related party transaction cannot be foreseen and aforesaid details are not available, audit committee may make omnibus approval for such transactions subject to their value not exceeding rupees one crore per transaction.

Validity of Omnibus Approval

Omnibus approval shall be valid for a period not exceeding one financial year and shall require fresh approval after the expiry of such financial year. It shall not be made for transactions in respect of selling or disposing of the undertaking of the company. Any other conditions may also be applicable as the Audit Committee may deem fit¹⁷.

Special Resolution is replaced by Resolution

By the notification dated 14th December 2015, Ministry of Corporate Affairs make the amendment in the Rule 15(3) of the Companies (Meeting of Board and Its Powers) Rules 2014. By the amendment the word "special resolution" is substituted by "resolution". Thus there no special resolution required in case of related party transaction only resolution passed by board is sufficient for the validity of the transactions.

Conclusion

These amended provisions issued by the Ministry in the name of Companies (Meeting of Board and its Powers) Second Amendment rule, 2015 is a good effort by the Ministry which needs to be praised. They have reduces the difficulties of the companies. These provisions of Companies (Meeting of Board and its Powers) Amendment rule, 2014 were a treat to small and medium enterprises but a black dot for larger companies.

Ministry from time to time has reduces the difficulties faced by the Companies, there the new amendment was came into picture in 14th Dec 2015. It will definitely removing the further difficulties. We believe that Ministry of Corporate affairs, as per requirement of time, will introduce new amendment if required. Now all Related Party Transaction are required to get omnibus approval from audit committee by annually. Now there is no ambiguity remain that approval is required for those which touch prescribed limit and mentioned section 188 or all. By the insertion of new amendment all related party transaction will get the omnibus approval for their legality otherwise it will draw the attention of non compliance of provision, penalty will be imposed over the concerned employees of the company.

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¹⁷ Rule 6A of the Companies (Meeting of Board and Its Powers) Rules 2014. MCA notification dated 14th Dec 2015.