**[Related Party Transactions under the Companies Act 2013](http://taxguru.in/company-law/related-party-transactions-companies-act-2013.html%22%20%5Co%20%22Permanent%20Link%20to%20Related%20Party%20Transactions%20under%20the%20Companies%20Act%202013)**

**Related Party Transactions under the New Era**

Companies Act, 2013 has unveiled a new era in the Indian Corporate Sector which places more reliance on disclosure norms rather than on approvals. One such area is “related party transactions”. While the Companies Act, 1956 warranted approval of Central Government for related party transaction by large cap companies, Companies Act, 2013 calls for larger disclosures with members’ approval.

Section 188 of the Companies Act, 2013 combines the erstwhile Sections 314 and 297 of the Companies Act, 1956 which deal with holding of office or place of profit and related party transactions respectively. Section 188 awaits notification by the Ministry of Corporate Affairs (MCA) to become applicable.

**ANALYSIS OF SECTION 188 OF COMPANIES ACT, 2013**

Section 188 requires a company to obtain approval of the Board and of the members, in certain situations, prior to entering of any transaction or agreement with a related party. An analysis of Section 188 requires understanding the following:

* Applicability of the Section
* Definition/Meaning of Related Party
* Transactions which are deemed as related party transactions
* Nature of approvals required
* Disclosure norms
* Exemptions/Non-applicability
* Consequences of non-compliance

We will proceed to understand the above dimensions.

**Applicability of the Section**

Section 188 is applicable to both private and public companies and will applicable from the date of its notification by the MCA. This Section has not been notified as yet.

**Definition/Meaning of Related Party**

Section 2(76), read with relevant rules made thereunder, defines a related party as under:

*“related party”, with reference to a company, means—*

*i. a director or his relative;*

*ii. a key managerial personnel or his relative;*

*iii. a firm, in which a director, manager or his relative is a partner;*

*iv. a private company in which a director or manager is a member or director;*

*v. a public company in which a director or manager is a director or holds along with his relatives, more than 2% of its paid-up share capital;*

*vi. any body 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;*

*vii. any person on whose advice, directions or instructions a director or manager is accustomed to act:*

*Provided that nothing in sub-clauses (vi) and (vii) shall apply to the advice, directions or instructions given in a professional capacity;*

*viii. any company which is—*

*(A) a holding, subsidiary or an associate company of such company; or*

*(B) a subsidiary of a holding company to which it is also a subsidiary;*

*ix. a director or key managerial personnel of the holding, subsidiary or associate company of such company or his relative;*

*x. any person appointed in senior management in the company or its holding, subsidiary or associate company i.e. personnel of the company or its holding, subsidiary or associate company who are members of core management team excluding Board of directors comprising all members of management one level below the executive directors, including the functional heads.*

**Related Party**

|  |  |
| --- | --- |
| **Individuals*** a director or his relative
* a KMP or his relative
* **a director or KMP of the holding, subsidiary or associate company of such company or his relative**
* **any person appointed in senior management in the company or its holding, subsidiary or associate company**
* **any person on whose advice, directions or instructions a director or manager is accustomed to act**
 | **Other than Individuals*** a firm, in which a director, manager or his relative is a partner
* a private company in which a director or manager is a member or director
* a holding, subsidiary or an associate company
* fellow subsidiary
* a public company in which a director or manager is a director or holds along with his relatives, more than 2% of its paid-up share capital
* any body-corporate whose BODs, MD or manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager
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**Transactions which are deemed as related party transactions**

Any transaction between a company and its related party relating to:

* 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;
* such related party’s appointment to any office or place of profit in the company, its subsidiary company or associate company; and
* underwriting the subscription of any securities or derivatives thereof, of the company.

*“office or place of profit” means any office or place—*

*(i) where such office or place is held by a director, if the director holding it receives from the company anything by way of remuneration over and above the remuneration to which he is entitled as director, by way of salary, fee, commission, perquisites, any rent-free accommodation, or otherwise;*

*(ii) where such office or place is held by an individual other than a director or by any firm, private company or other body corporate, if the individual, firm, private company or body corporate holding it receives from the company anything by way of remuneration, salary, fee, commission, perquisites, any rent-free accommodation, or otherwise;*

**Nature of approvals required**

**Approval of Board of Directors**

ü Every company needs to seek the approval of its Board of Directors for entering into any related party transaction, as listed above, irrespective of the capital of the company or the value of the transaction.

ü Approval of the Board has to be sought at a duly convened meeting of the Board and same cannot be obtained by passing of a resolution by circulation.

ü Where any director is interested in any contract or arrangement with a related party, such director shall not be present at the meeting during discussions on the subject matter of the resolution relating to such contract or arrangement.

**Prior approval of Members by means of special resolution**

ü In the following situations, in addition to approval of Board of Directors, prior approval of members by means of a special resolution must also be sought before entering into any related party transaction:

* paid-up share capital of the company is equal to or exceeds Rs. 1 Crore,
* the value of transaction individually or taken together with previous related party transactions during a financial year, exceeds 5% of the annual turnover or 20% of the net worth of the company as per the last audited financial statements of the company, whichever is higher,
* the transaction relates to appointment to any office or place of profit in the company, its subsidiary company or associate company at a monthly remuneration exceeding Rs. 1 Lakh.
* the transaction relates to remuneration for underwriting the subscription of any securities or derivatives thereof of the company exceeding Rs. 10 Lakhs.

ü No member of the company shall vote on such special resolution, to approve any contract or arrangement which may be entered into by the company, if such member is a related party.

ü In case of wholly owned subsidiary, the special resolution passed by the holding company shall be sufficient for the purpose of entering into the transactions between wholly owned subsidiary and holding company.

**Disclosure norms**

* Disclosures to be made in notice calling Board Meeting:

(a) name of the related party and nature of relationship;

(b) nature, duration of the contract and particulars of the contract or arrangement;

(c) material terms of the contract or arrangement including the value, if any;

(d) any advance paid or received for the contract or arrangement, if any; and

(e) any other information relevant or important for the Board to take a decision on the proposed transaction.

* Disclosures to be made in the explanatory statement to be annexed to notice of general meeting:

(a) name of the related party ;

(b) name of the director or key managerial personnel who is related, if any;

(c) nature of relationship;

(d) nature, material terms, monetary value and particulars of the contract or arrangement;

(e) any other information relevant or important for the members to take a decision on the proposed resolution.

* Disclosures to be made in Board’s Report:

Every related party transaction or contract shall be disclosed in the Board’s report along with the justification for entering into such contract or arrangement.

**Exemptions/Non-applicability**

The above mentioned provisions will not be applicable in case of transactions entered into by the company in its ordinary course of business, which are on arm’s length basis.

*“arm’s length transaction” means a transaction between two related parties that is conducted as if they were unrelated, so that there is no conflict of interest.*

**Consequences of non-compliance**

* If any related party transaction or contract is entered without seeking Board’s and/or Members’ approval and if the same is not ratified by the Board and/or Members as the case may be, within 3 months at a meeting, then the contract or transaction will be voidable at the option of the Board and if the transaction is with any related party to any director or is authorised by any other director, then the concerned directors are liable to indemnify any loss incurred by the company.
* Additionally, the company can also proceed against a director or employee who had entered into such contract or arrangement in contravention of the provisions of this section for recovery of any loss sustained by it as a result of such contract or arrangement.
* Any director or any other employee of a company, who had entered into or authorised the contract or arrangement in violation of the provisions of this section shall –

(*i*) in case of listed company, be punishable with imprisonment for a term which may extend to 1 year or with fine which shall not be less than Rs. 25,000/- but which may extend to Rs. 5,00,000/-, or with both; and

(ii) in case of any other company, be punishable with fine which shall not be less than Rs. 25,000/- but which may extend to Rs. 5,00,000/-.