

**RELATED PARTY TRANSACTIONS AND REGULATORY OVERSIGHT UNDER THE
COMPANIES ACT, 2013**

Animesh Mukhopadhyay, FCA,

Co-authored by Antika Mukherjee, CS.

In common parlance and as sourced from the Cambridge Dictionary, “Related Party” *means a person or a company, for example, a shareholder or a company in the same business group, that is connected to the person or company previously mentioned and often has a control or influence over that person or company.*

In the last few years, there exist several instances of reputed corporates undertaking related party transactions, by way of shielding adequate disclosures with the market regulators. While the determination of related party transactions may be essentially complex for both professionals and companies, it is essential to undertake necessary compliances before initiation of a contract(s) or arrangement(s) with Related Parties.

DECODING- “RELATED PARTY”

COMPANIES ACT, 2013	ACCOUNTING STANDARDS- 18
Section 2(76): “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 or his relative is a member or director; (v) a public company in which a director or manager is a director and holds along with his relatives, more than two per cent 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;	Clause 10.1 of the Accounting Standards 18 defines “Related Party” as, <i>“Parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.</i> Further, the Institute of Chartered Accountants of India (ICAI), vide Standards on Internal Audit 18, Para 3 (i) , has defined the term “Related Party” on similar lines as stated in AS 18. Additionally, the following concepts are extremely pertinent to add here: Meaning of “Control” and “Significant Influence” (a) Ownership, directly or indirectly, of more than one half of the voting power of an enterprise, or

<p>(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.”</p> <p>(viii) any body corporate which is— (A) a holding, subsidiary or an associate company of such company; (B) a subsidiary of a holding company to which it is also a subsidiary; or (C) an investing company or the venturer of the company;”</p> <p>(ix) such other person as may be prescribed.”</p>	<p>(b) Control of the composition of the board of directors in the case of a company or of the composition of the corresponding governing body in case of any other enterprise, or</p> <p>(c) A substantial interest in voting power and the power to direct, by statute or agreement, the financial and/ or operating policies of the enterprise.</p> <p>Significant Influence: Participation in the financial and/ or operating policy decisions of an enterprise, but not control of those policies.</p>
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UNDERSTANDING “RELATED PARTY TRANSACTIONS” IN THE LIGHT OF COMPANIES ACT, 2013

One of the most complex and infamous sections of the Companies Act, 2013 (**“Companies Act”**), Section 188 provides a comprehensive list of certain specific transactions considered to be Related Party Transactions (**“RPTs”**) and the associated disclosure requirements along with. The Section also deals with the penal provisions arising in case of any contravention.

Every company, be it private, public or listed, is required to source approval from its Board of Directors before entering into any RPT. Companies shall ensure that the circulated Board Agenda contains the following disclosures herewith:

- a. Name of the related party and nature of the relationship
- b. The nature, duration of the contract and particulars of the contract or arrangement.
- c. The 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.
- e. Manner of determining the pricing and other commercial terms.
- f. Whether all the factors relevant to the contract have been considered or not.
- g. Any other relevant information for the Board to take such decision.

However, Companies must ensure compliance with Rule 15 of the Companies (Meeting of Board and its Power) Rules, 2014, in case of undertaking any RPT which exceeds the threshold limits as have been specified. A list of all such specific transactions along with their respective threshold limits have been presented herein below:

S.NO	PARTICULARS OF THE TRANSACTION	THRESHOLD LIMITS
1.	Sale, purchase or supply of any goods or material, directly or through the appointment of an agent.	Amounting to ten percent or more of the turnover of the company
2.	Sale or otherwise disposing of or buying property of any kind, directly or through appointment of agent,	Amounting to ten percent or more of the net worth of the company
3.	Leasing of property any kind.	Amounting to ten percent or more of the net worth of the company
4.	Availing or rendering of any services, directly or through appointment of agent,	Amounting to ten percent or more of the turnover of the company
5.	Appointment to any office or place of profit in the company, its subsidiary company or associate company.	Monthly remuneration exceeding two and a half lakh rupees.
6.	Remuneration for underwriting the subscription of any securities or derivatives thereof, of the company.	Exceeding one percent of the net worth of the Company.

Note that the turnover or net worth referred to above shall be computed on the basis of the audited financial statement of the preceding financial year.

Further, in case of any member of the company being a related party, they shall abstain from voting on a resolution to approve any of the aforesaid contract (s) or arrangement (s). However, the aforesaid provision **shall not** apply to a company in which ninety per cent or more members, in number, are relatives of promoters or are related parties.

The Companies Act, however, gives a leeway to the Companies by specifying that in case of the aforesaid transactions being carried out in the “ordinary course of business” and at “arms-length basis” there shall not arise any requirement of seeking the members’ approval.

Even though the Act uses the term “ordinary course of business”, it does not define the same.

Referring to Black's Law Dictionary, the term "**ordinary course of business**" is said to mean ***"as the normal routine in managing a trade or business."***

To decode the term, it would mean any transaction which is carried out by the company in its normal course and in furtherance of its objects, as may have been stated in the Company's charter documents.

For example, In case of a manufacturing company deciding to acquire another company involved in the business, the same would not be considered to be an activity carried out in the "ordinary course of business."

In the case of ***Seksaria Biswan Sugar Factory vs Commissioner Of Income-Tax***, the Hon'ble Bombay High Court opined that an amount lent by the company to a third party will not be in the ordinary course of business. The Court observed that just because an activity is included in the Memorandum of Association, the activity does not become an activity in the ordinary course of business of the company.

Note: However, the position will be different based on the facts of the case, i.e., if the company is engaged in financial activities or lending or investing in subsidiaries, associates and joint ventures, the said activities would be considered in the ordinary course of business.

The Act however, does not clearly lay down any test for determination of the same and it is subject to the discretion of the Board.

Section 188 of the Companies Act defines the term "arm's length transaction" to mean **a transaction between two related parties that is conducted as if they were unrelated, so that there is no conflict of interest.**

In the case of ***"Iljin Automotive Private Limited Vs Asst. Commissioner of Income Tax"***, ***Hon'ble ITAT, Chennai*** opined that "the determination of 'arm's length price' seeks answer to the question – What would have been the price if the transactions were between two unrelated parties, similarly placed as the related parties in so far as nature of product, and terms and conditions of the transactions are concerned?

Thus, it can be well understood that in the case of determination of an arms' length transaction, the transaction as a whole and the bundle of terms and consideration need to be considered for arriving at a necessary conclusion.

REVISITING THE PROVISIONS OF RPT UNDER THE COMPANIES ACT, 1956

Companies Act, 1956, did not entail any separate definition for “Related Parties.” Section 297 of the erstwhile Act, dealt with RPTs and its disclosures, similar to Section 188 of the present Companies Act, in some aspects.

Upon plain reading of Section 297 of the former act, it is understandable that the following parties are restricted from undertaking any specific contract(s) or arrangement(s), without seeking due approval from the Board,

“...a director of the company or his relative, a firm in which such a director or relative is a partner, any other partner in such a firm, or a private company of which the director is a member or director”

The former provision covered only sale and purchase of goods, rendering of services and underwriting the subscription of shares or debentures, having a much narrower ambit as compared to the present provisions governing RPTs.

Section 297 entailed mandatory approval of the Central Government (“CG”), in case of the concerned company’s paid-up capital exceeding rupees one crore. With the implementation of Section 188 of the present Companies Act, the requirement of CG approval has been done away with and replaced with shareholders’ approval, in cases where specified threshold limits have been exceeded.

AUDIT COMMITTEE’S INTERVENTION

In case of Companies having Audit Committees in place, Section 177 of the Companies Act authorizes such Committees with the power to approve the RPTs undertaken by the Company and recommending the same to the Board for their consideration and approval.

While determining the nature of the transaction being in its natural course of business, the Committee may refer to the Company’s framed policy on RPTs. In case the Company undertakes a handful of RPTs during the year, the Committee has the power of granting omnibus approval, subject to a validity of one year.

TO-DO’S BY COMPANIES ENTERING INTO RPTs

1. In case of any contract or arrangement with a related party, wherein a director is interested, such director **shall not be present** at the meeting during discussions on the subject matter of the resolution relating to such contract or arrangement.

By way of a **Ministry of Corporate Affairs (MCA) notification dated June 05, 2015**, Directors of private companies were granted the privilege of voting, even in case of being interested.

2. In case of a wholly owned subsidiary, the resolution shall be passed by the holding company and will be treated as sufficient for the purpose of entering into the transaction between the wholly owned subsidiary and the holding company.
3. In accordance with the requirements of Section 134 of the Companies Act, any specific contract or arrangement requiring shareholders' approval, the same shall be referred to in the Board's report along with the justification for entering into such contract or arrangement.
The same shall be required to be disclosure in **Form AOC-2** as a separate annexure in the Board's Report.
4. In case of any contract or arrangement is entered into by a director or any other employee, without obtaining the consent of the Board or approval by way of a resolution in the general meeting and if it is not ratified by the Board, or, by the shareholders at a meeting **within three months from the date** on which such contract or arrangement was entered into; such contract or arrangement **shall be voidable** at the option of the Board or of the shareholders.

MAINTENANCE OF RECORDS

The Act mandates it for every company to maintain registers detailing out the particulars of all such contract(s) or arrangement(s) w.r.t Section 184 or 189 of the Act. Such registers shall be required to be initialed by all the Directors at the subsequent board meeting. Every Director who fails to comply with the provision shall be liable to a penalty of twenty-five thousand rupees.

In **May, 2023**, the **Registrar of Companies (ROC), Ahmedabad**, passed an adjudication order against Adani Power Limited for non-disclosure of related party transactions entered in during FY 2017-18 to 2019-20, in the register maintained under Section 189 of the Companies Act. While the company's authorized representative argued that such transactions were carried out in the ordinary course of business and at arm's length, adequate evidence was not provided to substantiate the claim.

Eventually, the regulator imposed a hefty penalty of **INR 75,000/- each** on the three senior executives of the Company, including its Chairperson.

The aforesaid case is a classic example of how large conglomerates often flout the laws by taking shield of the exemptions provided, without possessing substantial evidence. It also denotes how the ROC stresses on the maintenance of adequate registers and records by the

Companies and in the absence of the same, will have to bear the brunt of hefty monetary compensation.

In spite of the regulators keeping a stringent watch on ensuring adequate disclosure is made by Companies, they often fall short in determining how one might make use of the loopholes of the Act. Stakeholders are expectant as to how the law-makers navigate the many complexities still persisting in the Act and framing it in a manner to promote good corporate governance and transparency among corporates.
