



## **Compliances with Companies Act, 2013 by Private Limited Companies – Part II**

*This write up provides an overview of the applicability of related party transactions to private companies, requiring compliances at a Board and Shareholder level.*

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### **Related Party Transactions**

The provisions relating to [related party](#) transactions under Section 188 of the Companies Act, 2013, are now applicable to all companies including private companies.

The following transactions with related parties cannot be entered into by a company except with the consent of the Board of Directors *at a meeting of Board*:

- 1) Sale, purchase or supply of any goods or materials;
- 2) Selling or otherwise disposing off or buying property of any kind;
- 3) Leasing property of any kind;
- 4) Availing or rendering of services;
- 5) Appointment of an agent for purchase or sale of goods or materials services or properties;
- 6) The appointment of the related party to any office or place of profit in the company, its subsidiary or associate company;
- 7) Underwriting the subscription of securities or derivatives of the company.

Pursuant to the first proviso of Section 188 (1), the [Chapter 12 Rules](#) provide the thresholds beyond which every related party transaction requires special resolution of the members of the Company.

### **Compliances needed**

- 1) Board meeting and passing of board resolution. The rules prescribe the compliances in relation to [notice of meetings](#).
- 2) In cases where the [Thresholds](#) are met, an extra-ordinary general meeting of the shareholders has to be convened for approving the same. The compliances in relation to the EGM are available [here](#).
- 3) The contract / arrangement shall be reported in the Board report / directors report which shall be forwarded to shareholders along with rationale, basis or justification for entering into such transaction.



Under this Act, unlike the earlier Companies Act, no approval of Central Government is needed for appointment of directors to office or place of profit in the Company or its subsidiary

### **Exceptions**

No compliances are needed where the related party transactions are :

- (a) in the ordinary course of business and
- (b) carried on an arms length basis.

Arms length is defined under the Act as a transaction between two related parties that is conducted as if they were unrelated so that there is no conflict of interest.

Apart from the aforesaid, no other exceptions are applicable to related party transactions under the Act.

#### *Identifying the Exceptions*

The common test for identifying whether the transaction is in the ordinary course of business, would be to check and confirm whether the proposed transaction(s) is covered under the object clause of the Company and/ or incidental/ ancillary to the attainment of objects of the Company.

In order to ascertain whether the transaction is on arm's length basis, one should check and confirm whether the terms of contract / arrangement are similar to the terms that are generally entered into with other parties who are unrelated.

It would be advisable to obtain confirmation from the Auditors as well on whether the views of the company are in line with the auditors' views on whether certain transactions are in ordinary course and on arm's length basis.

The procedure laid down under the Act and Rules should be followed for transactions that are with related parties and not in the ordinary course of business or not on arms length basis.

### **Thresholds**

Rule 15 (3) provides the thresholds as follows:

- 1) A company with paid up capital of INR 10 crores or more shall obtain prior approval of the members by way of a special resolution for a contract or arrangement with a related party; *or*
- 2) Transactions meeting the following thresholds shall require a special resolution:
  - a. as contracts or arrangements with respect to items 1 to 5 listed above with criteria, as mentioned below –
    - i. sale, purchase or supply of any goods or materials directly or through appointment of agents over 25% of the annual turnover;
    - ii. selling or otherwise disposing of, or buying, property of any kind directly or through appointment of agents over 10% of net worth;



- iii. leasing of property of any kind over 10% of the net worth or exceeding 10% of turnover;
- iv. availing or rendering of any services directly or through appointment of agents exceeding 10% of the net worth.
- b. appointment to any office or place of profit in the company, its subsidiary company or associate company at a *monthly* remuneration exceeding INR 2.5 lakhs; or
- c. remuneration for underwriting the subscription of any securities or derivatives thereof of the company exceeding 1% of the net worth.

One of the ways to interpret the thresholds is to say that related party transactions of companies meeting the paid up capital thresholds exceeding the transactional thresholds mentioned in second part of the rule only require special resolution.

However, the relevant proviso as well as the rule requires all companies to follow certain norms for entering into related party transactions. This will include a wide net of private companies that provide inter-group support. However, the paid up capital threshold of INR 10 crores is quite high exempting many smaller companies from the rigours of compliance at a shareholder level.

#### *Non-compliance*

Any contract entered into with a related party in contravention of the provisions of Section 188 of the Act is voidable at the option of the Board.

Further, any such contract if so authorized by any Director in contravention of the provisions, would entail the concerned Director indemnifying the Company against any loss incurred by the Company.

The offence is punishable with fine which shall not be less than INR 25,000/- but which may extend to INR 5 Lakhs.

#### **Who are related parties?**

The following are related parties under the Act and Rules:

- 1) Director or his [relative](#);
- 2) A KMP 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) 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;



- 7) 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;

- 8) 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;
- 9) such other person as may be prescribed. The Companies (Specification of definition details) Rules, 2014 state that for the purpose of this sub-clause of the definition of “related party”, a director or KMP of the holding company *or the relative of such director or KMP* with reference to a company, shall be deemed to be a related party.

*Comment: Interestingly, the Chapter 12 Rules define Related Party to simply cover only this item 9. Whereas the definition under the Act is very wide and covers all persons described in items 1 – 9. Does it mean the rules apply only to the parties described in item 9? In our view, irrespective of the definition in the rules, the rules would apply to all the 9 classes of related parties mentioned above and any others that may be notified in future.*

### *Identifying related parties*

Following disclosures should be obtained for preparing the above list of Related Parties:

- i. Notice of interest by Director.
- ii. Disclosure from KMP giving information about their relatives.
- iii. Disclosure from HR Department about names of senior management of the Company i.e. members of core management team excluding Board of Directors comprising all members of management one level below the executive directors, including the functional heads.
- iv. Disclosures from Associate Company about the names of senior management i.e. members of core management team excluding Board of Directors comprising all members of management one level below the executive directors, including the functional heads, of the Associate Company.
- v. Disclosure from a Holding Company about the following:
  - a. Names of its Directors and their relatives.
  - b. Names of its other Subsidiary Companies.
  - c. Names of Directors and their relatives on the board of the subsidiary companies of the holding company.
  - d. Names of KMP’s of Holding Company and their relatives.
  - e. Names of KMP’s of Subsidiary Companies of the Holding Company and their relatives.



- f. Names of senior management i.e. members of core management team excluding Board of Directors comprising all members of management one level below the executive directors, including the functional heads of the Holding Company.
  - g. Names of senior management i.e. members of core management team excluding Board of Directors comprising all members of management one level below the executive directors, including the functional heads, of its Subsidiary Company(ies).
- vi. Disclosure from Manager about the following:
- a. Names of Firms in which he or his relative are partners.
  - b. Names of private limited companies in which he is a Director or holds along with relatives more than 2% of its paid-up share capital.
- vii. Disclosure from Subsidiary Company about the following:
- a. Names of its Directors and their relatives.
  - b. Names of KMP's and their relatives.
  - c. Names of senior management i.e. members of core management team excluding Board of Directors comprising all members of management one level below the directors, including the functional heads of the Subsidiary Company.

**Relative**

A relative is defined under the Act and Rules to include the following:

- a) Members of HUF;
- b) Husband or wife;
- c) Father and mother (including step parents);
- d) Son and son spouse;
- e) Daughter and daughter's husband;
- f) Brother (including step brother);
- g) Sister (including step sister).



## COMPLIANCES

### Board level compliances

(1) The agenda of the Board meeting at which the board resolution is proposed to be moved shall disclose-

- A. The name of the related party and nature of 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. The manner of determining the pricing and other commercial terms, both included as part of contract and not considered as part of the contract;
- F. Whether all factors relevant to the contract have been considered, if not, the details of factors not considered with the rationale for not considering those factors; and
- G. Any other information relevant or important for the Board to take a decision on the proposed transaction.

(2) 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.

### EGM Compliances

In cases where a special resolution of the members / shareholders is needed, the Board should approve the notice of General Meeting/ Postal Ballot for passing Special Resolution.

The explanatory statement in the notice should contain the following particulars:

- a) Name of the related party.
- b) Name of the Director or KMP who is related, if any.
- c) Nature of relationship.
- d) Material Terms.