



INTERNATIONAL LAW
JOURNAL

**WHITE BLACK
LEGAL LAW
JOURNAL
ISSN: 2581-
8503**

Peer - Reviewed & Refereed Journal

The Law Journal strives to provide a platform for discussion of International as well as National Developments in the Field of Law.

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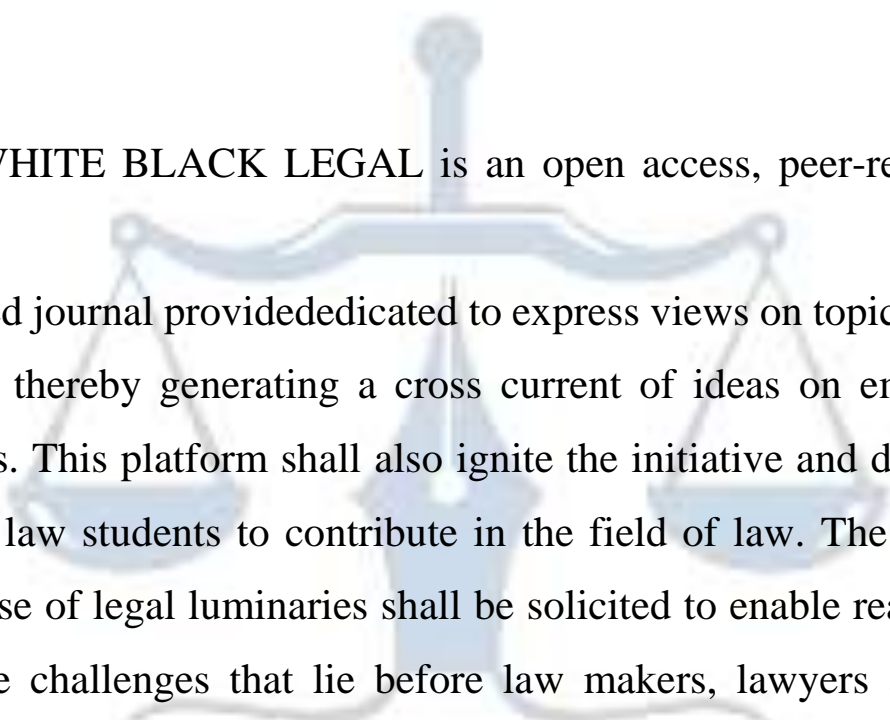


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ABOUT US



WHITE BLACK LEGAL is an open access, peer-reviewed and refereed journal providededicated to express views on topical legal issues, thereby generating a cross current of ideas on emerging matters. This platform shall also ignite the initiative and desire of young law students to contribute in the field of law. The erudite response of legal luminaries shall be solicited to enable readers to explore challenges that lie before law makers, lawyers and the society at large, in the event of the ever changing social, economic and technological scenario.

With this thought, we hereby present to you

RELATED PARTY TRANSACTIONS

AUTHORED BY - RACHIT RAWAT

Related Party Transactions

Before understanding what a related party transaction is and what all laws and regulations govern it first let us understand what is a Related Party

Who is a Related Party?

The definition of the related Party is given u/s 2(76) of the Companies Act to be read with Regulation 2(zb) of SEBI (LODR) Regulations as –

- “Director and KMP or their relatives, relatives are defined under Sec. 2(77) of the Companies Act which says that relatives are members of HUF, husband and wife or one person is related to another in such manner as may be prescribed.
- The firm where a director, manager, or their relatives are partners.
- a private company in which a director or manager is a member or director
- a public company in which a director or manager is a director or holds along with his relatives, more than two percent. of its paid-up share capital
- any body corporate whose Board of Directors, managing director, or manager is accustomed to acting in accordance with the advice, directions, or instructions of a director or manager
- The above given 2 points will not cover a company that is a holding, subsidiary, or an associate company of that company or a subsidiary of a holding company to which it is also a subsidiary.”

Legislations Monitoring the Related Party Transactions

A Related Party Transaction is a transaction entered into by an entity with its related party. These transactions are monitored and controlled by various Legislations, Rules and Regulations. They are:

- i. COMPANIES ACT 2013.
- ii. COMPANIES (MEETINGS OF BOARD AND IT’S POWER) RULES, 2014
- iii. SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015

iv. OTHER RELEVANT PROVISIONS DEALING WITH RELATED PARTY TRANSACTIONS

Companies act, 2013¹

Section 188 of the Companies Act deals with Related Party Transactions.

Section 188(1) of the Act provides for the approval of the board for the following contract or arrangements with a related party:

- 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 the 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

Section 188(2) states that, every Contract or arrangement as mentioned in the above sub section shall be referred in the board's report. The report is to be sent to the Shareholders along with the reason/ justification for entering into such contract or arrangement.

Section 188(3) states that, if a contract or arrangement is entered into, without the approval of the board or, the Shareholders and if it is not ratified by the board or the shareholders, within a period of 3 months from the date of entering into such contract or arrangement, the transaction shall be voidable at the option of the directors or the shareholders. If such agreement is entered into with a party who is a related party to any director or is ratified by any director, such director shall be liable to indemnify the company in case of loss incurred by such agreement.

Section 188(4) states that, the company can proceed against any director or employee for recovery of any loss incurred due to any agreement entered by him in contravention of the provisions.

¹ <https://www.mca.gov.in/Ministry/pdf/CompaniesAct2013.pdf>

Section 188(5) provides that a penalty will be imposed on the employee or director in case of violation of the mentioned provisions. the penalty will be of Rs. 25 lakhs in case of Listed Company and Rs. 5 lakhs in case of any other company.

The above-mentioned provisions will not apply in the following cases:

- i. Transaction done on Arms Length's basis².
- ii. Transaction done between Holding and Wholly Owned Subsidiary Company, whose accounts are consolidated with the Holding Company

Companies (meetings of board and it's power) rules, 2014³

Rule 15 – Contract or Arrangement with a related party.

Rule 15(1) states that the agenda to be sent with the notice of the Board meeting at which the resolution is proposed to be passed shall disclose all the necessary information relating to relation with the related party, duration and particulars of the contract or arrangement to be entered into.

Rule 15(2) states that if any director is interested in any contract or arrangement with a related party, such director shall not be present at the meeting in which resolution relating to such contract or arrangement is being discussed.

Rule 15(3) states that the transactions will require the approval of the Shareholders:

- a. Above mentioned transactions, if they are above a specified threshold limit.
- b. The appointment to any office or place of profit in the company, its subsidiary company, or associate company if monthly remuneration is above Rs. 250,000.
- c. The remuneration for underwriting the subscription of any securities or derivatives of the company is above 1% of the net worth.

² 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.

³ https://www.mca.gov.in/Ministry/pdf/NCARules_Chapter12.pdf

SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015

Regulation 23 of SEBI LODR Regulations- Related Party Transactions:

1. The listed entity shall formulate a policy on the materiality of the related party transactions and on dealing with related party transactions. Such policy shall also include the threshold limits as decided by the BOD and it is to be reviewed once every three years.
2. The approval of the independent directors who are the member of audit committee is required for all related party transactions.

What is a Material Transaction?

The SEBI LODR Regulations defines material transactions as;

“- any transaction, individually or taken together with previous transactions during a financial year, exceeds rupees 1000 crores or 10% of the annual consolidated turnover of the listed entity as per the last audited financial statements of the listed entity, whichever is lower.

- if a payment is made to a related party for brand usage or royalty, taken individually or together, exceeds 5% of the annual consolidated turnover of the listed entity as per the last audited financial statements of the listed entity.”

- All material-related party transactions shall require approval of the shareholders by a resolution to be passed in the General Meeting.

What is Omnibus Approval?

The audit committee may grant omnibus approval for related party transactions proposed to be entered into by the listed entity subject to the following conditions-

- a) the audit committee shall lay down the criteria for granting the omnibus approval along with the policy on related party transactions and such approval shall be applicable for repetitive transactions;
- b) the audit committee shall be of the opinion that such omnibus approval is in the interest of the listed entity;
- c) the omnibus approval shall specify all the necessary details regarding the Related Party and necessary details regarding the transaction. The Audit committee is authorized to grant the omnibus approval of transactions up to the limit of Rs. 1crore if such details are not available.

- d) the audit committee shall review the details of related party transactions entered into by the listed entity pursuant to each of the omnibus approvals given.
- e) Such omnibus approvals shall be valid for a period of one year.

Exceptions

The approval of the Audit Committee and shareholders shall not be required in the following cases:

- (a) transactions entered between two government companies.
- (b) transactions entered between a holding company and its wholly owned subsidiary.

Other relevant provisions

- The provisions of this regulation shall be applicable to all prospective transactions.
- For this regulation, all entities falling under the definition of related parties shall abstain from voting irrespective of whether the entity is a party to the particular transaction or not.

Other relevant provisions dealing with related party transactions

- Indian Accounting Standard (Ind AS)- 24 - Related Party Disclosures.
- Accounting Standard (AS)- 18 - Related Party Disclosures.

Recent Developments in the topic

Key Amendments⁴

a. Definition of related party

Definition of Related Party which is given under Regulation 2(1) (zb) of LODR. The definition now includes an entity or person who forms a part of the promoter or promoter group which will be irrespective of the shareholding. Another change was that a person on an entity who holds more than 10% or more in the listed entity (either directly or on a beneficial interest basis) at any time during the immediately preceding financial year.

⁴<https://www.azbpartners.com/bank/lodr-amendments-on-related-parties-some-practical-challenges/#:~:text=Pursuant%20to%20the%20proviso%20to,listed%20entity%20%E2%80%93%20with%20the%20quantitative>

b. Definition of RPT-

This amendment expands the definition of Related Party Transactions (RPTs) for listed entities in India. The new definition encompasses a broader range of transactions, including those involving the transfer of resources, services, or obligations, regardless of whether a price is charged. It covers two main scenarios: first, transactions between a listed entity or its subsidiaries and a related party of either the listed entity or its subsidiaries; and second, transactions between a listed entity or its subsidiaries and any other person or entity, provided the purpose and effect of such transactions is to benefit a related party of the listed entity or its subsidiaries.

c. Threshold for material RPT-

The new limit/threshold was added of Rs. 1000cr. The provision now is that either 1000 cr. or 10% of the company's annual turnover, whichever is lower.

d. Prior approval of the audit committee of the listed entity

There was an amendment to Regulation 23 (2) (c) of LODR Regulations which required audit committee approval for transactions involving their subsidiary, even when the listed company is not directly involved. The approval is only required by to company if the amount of transaction exceeds 10% of the subsidiary's annual turnover.

Director's duty to disclose interest⁵

- The director must mandatorily disclose the agreement where they have a direct or an indirect interest and non-disclosure will lead to penalties, vacation of office and disunification from directorship.
- Director should notify the Board at meetings where relevant transactions are discussed.
- Companies should maintain a register of transactions above a certain threshold involving directors' interests, which should be open for member inspection and
- Interested directors should not participate in Board meetings during discussions of items in which they have an interest.

⁵<https://www.mca.gov.in/content/mca/global/en/data-and-reports/reports/other-reports/report-company-law/related-party-transactions.html>

2. Certain transactions, in which directors are interested, take place only subject to the approval of the Board/shareholders-

- Transactions between the company and directors or connected persons regarding sale, or purchase of goods, materials, or services require Board approval, subject to a threshold limit.
- Transactions exceeding a specified limit require shareholder approval via special resolution, with details provided in an explanatory statement.
- Cash transactions at market price remain exempt under Section 297(2)(a) of the Companies Act.

3. Restrictions on Loans to the director or holding office or place of profit by a relative of a director

- Generally, a director should not take a loan from the company and if he wants to take then shareholder approval through special resolution should be taken.
- Funding of legitimate company-related director expenses exempt from these regulations.
- Money lending companies may have different rules for loans to employee-directors, subject to RBI and other regulatory oversight.
- Directors or their relatives can hold office of profit up to a specified limit with shareholder approval but Managing Director and Whole-Time Director positions are excluded from this category.
- Funding of legitimate company-related director expenses exempt from these regulations.

4. Duty on directors to disclose information relating to directorship and shareholdings in the company and in other companies

- Directors would be required to disclose to their company:
 - i. Personal details as prescribed by rules
 - ii. Other directorships held
 - iii. Shares or debentures held by them and their relatives in the company and other companies
 - iv. Companies where they or their relatives hold a significant percentage of shares
 - v. Other entities where they have direct or indirect interests

vi. Any changes to the above information within a specified timeframe

- Failure to disclose would result in fines. The company must maintain a register with these details for each director, which should be open for inspection by all company members.

