

SECTION 188 OF COMPANIES ACT, 2013- PROVISIONS ON RELATED PARTY TRANSACTIONS



CS Foram Gada

Email : csgadaforum@gmail.com

Section 188 of Companies Act, 2013 contains the Provisions of Related Party Transactions, which are to be complied by the Companies. The Provisions of Section 188 are applicable to Private Company and Public Company (Listed and Unlisted).

I) **First and Foremost, let us understand who is a Related Party under Companies Act, 2013:**

As per Section 2(76) read with The Companies (Specification of definitions details) Rules, 2014, "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;
- (vii) any person on whose advice, directions or instructions a Director or Manager is accustomed to act:

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

- (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;
- (ix) such other person as may be prescribed;

As per The Companies (Specification of definitions details) Rules, 2014: For the purposes of sub-clause (ix) of clause (76) of section 2 of the Act, a Director[other than an Independent Director] or Key Managerial Personnel of the Holding Company or his relative with reference to a Company, shall be deemed to be a related party.

II) After determining a Related Party, it is also important to identify the Related Party Transactions:

As per Section 188(1), except with the consent of the Board of Directors given by a resolution at a meeting of the Board and subject to such conditions as may be prescribed, no Company shall enter into any contract or arrangement with a related party with respect 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

INTERPRETATION AND EXPLANATION OF POINT (I) AND (II):

To ascertain whether provisions of Section 188 of the Companies Act, 2013 are applicable on a certain transaction, both of the following criteria must be fulfilled:

1. Whether the transaction is entered into with a Related Party as defined under Section 2(76) of Companies Act, 2013 and The Companies (Specification of definitions details) Rules, 2014 **(As explained in Point I earlier)**;

AND

2. Whether a Contract or Arrangement is a Related Party Transaction as per clauses (a) to (g) of Section 188(1) of Companies Act, 2013 **(As explained in Point II earlier)**.

If an entity/person is, a Related Party AND Contract or Arrangement is a Related Party Transaction then Company will have to comply with the provisions of Section 188 of Companies Act, 2013.

It is to be noted that if any one of the above criteria is not fulfilled, provisions of Section 188 of Companies Act, 2013 shall not be attracted.

III) Approval for entering into Contact or Arrangement:

As per the first proviso of Section 188(1) no contract or arrangement, in the case of a Company having a paid-up share capital of not less than such amount, or transactions not exceeding such sums, **as may be prescribed**, shall be entered into except with the prior approval of the Company by a resolution.

Limits of Transactions are mentioned in Rule 15 of Companies (Meetings of Board and its Powers) Rules, 2014. If the transaction exceed the following limits, it shall require approval of the Company by a resolution:

1. sale, purchase or supply of any goods or material, directly or through appointment of agent- **10% or more of turnover**
2. selling or otherwise disposing of or buying property of any kind, directly or through appointment of agent- **10% or more of net worth**
3. leasing of property any kind- **10% or more of turnover**
4. availing or rendering of any services, directly or through appointment of agent- **10% or more of turnover**

The above limits mentioned in 1 to 4 shall apply for transaction or transactions to be entered into either individually or taken together with the previous transactions during a financial year.

5. Others:
 - a. 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 a half (2.5) lakh rupees**
 - b. is for remuneration for underwriting the subscription of any securities or derivatives thereof, of the Company- **exceeding 1% of net worth**

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

IV) Explanatory Statement of the Notice of General Meeting convened for obtaining approval of Related Party Transactions:

The explanatory statement to be annexed to the notice of a general meeting convened pursuant to section 101 shall contain the following particulars, namely:-

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

V) Provision in case of Wholly Owned Subsidiary:

As per Rule 15(2) of The Companies (Meetings of Board and its Powers) Rules 2014, in case of wholly owned Subsidiary, the resolution passed by the Holding Company shall be sufficient for the purpose of entering into the transaction between the wholly owned Subsidiary and the Holding Company.

VI) Arm's Length Transaction:

“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.

If the transaction is in the ordinary course of business and undertaken on arm's length basis, it shall not need the approval of the Board or the Company.

VII) Ratification of Contract or Arrangement:

As per Section 188(3),

Where any contract or arrangement is entered into by a Director or any other employee, without obtaining the consent of the Board or approval by a resolution in the general meeting under subsection (1) and if it is not ratified by the Board or, as the case may be, by the shareholders at a meeting within three (3) 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, as the case may be, of the shareholders.

If the contract or arrangement is with a party related to any Director, or is authorised by any other Director, the Directors concerned shall indemnify the Company against any loss incurred by it.

VIII) Penalty:

As per Section 188(5),

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-Twenty-Five (25) Lakh Rupees
- (ii) In case of any other Company- Five (5)Lakh Rupees

IX) Others:

1. As per Section 188(2), details of every contract entered into shall find its reference in the Board's report along with justification about the same.
2. No Member/Director shall vote on the resolution if they are related party.
3. As per Section 188(4), company can proceed against a Director or any other 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.

