



The Institute of Chartered Accountants of India

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# **Provisions relating to Loans to Directors, Loans/ Investments by Companies, Acceptance of Deposits and Related Party Transactions**

## **Seminar on Companies Act, 2013 WIRC of ICAI**

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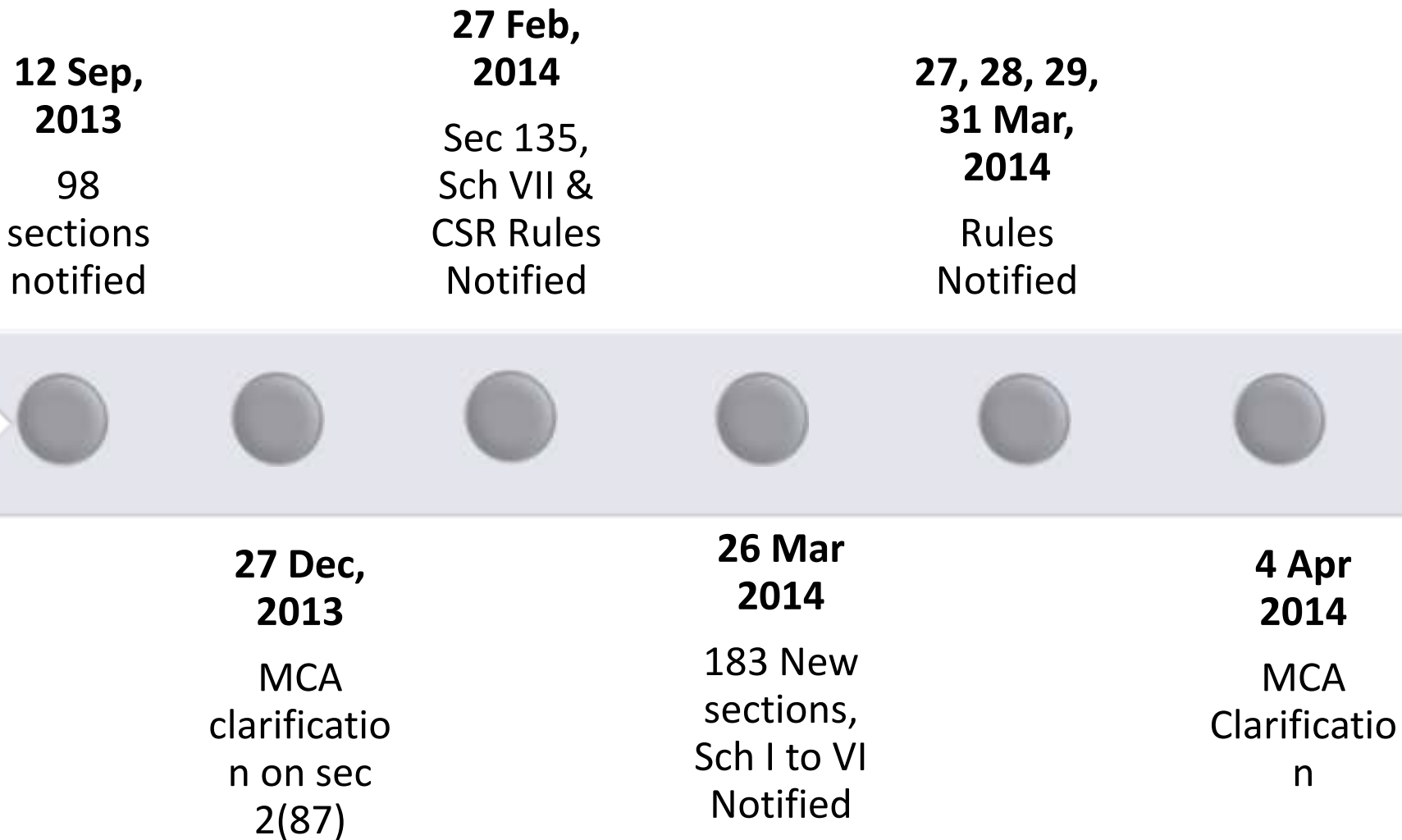


# Today's Agenda

- Companies Act, 2013
  - Journey So far
  - Few new concepts
- Provisions relating to:
  - Acceptance of Deposits by Companies [Sec 73 to 76 Chapter V]
  - Loans to Directors [Sec185 Chapter XII]
  - Loans and Investments [Sec186 Chapter XII]
  - Related Party Transactions [Sec188 Chapter XII]



# Journey So far





# Some Developments

- Several amendments approved by NAMO govt
- Draft notification put up by the MCA on its website on June 24, 2014 (**several exemptions for Private Limited Companies**)
- Reported revised draft of this notification laid before the Parliament on July 14, 2014
- Notification dated October 14, 2014
- Press Release dated December 2, 2014
- Companies' Amendment Bill introduced in Lok Sabha on December 12, 2014 and passed on December 17, 2014



# Several New Concepts

- One Person Company
- Small Company & Dormant Company
- Corporate Social Responsibility [CSR]
- National Financial Reporting Authority [NFRA]
- National Company Law Tribunal [NCLT]
- Maximum number of directorships
- Provision for women & Independent director
- Fast Track M&A in a few cases
- Introduction of class action suites
- Re-opening & revision of accounts
- Rotation of Auditors



# Provisions Regarding

# Acceptance of Deposits by Companies [Chapter V]

Fix Deposit





# Acceptance Of Deposits By Cos

Section 73 Corresponding to Sec 58A

On and after the commencement of this Act, no company shall invite, accept or renew deposits under this Act from the public except in a manner provided under this Chapter:

*Not applicable to a banking company and NBFC as defined in RBI Act, 1934 and to such other company as the CG may specify, after consultation with the RBI*





# Does not apply to

- Such companies as specified in the Rules:
  - Banking Co. [defined in S. 2(9) of the Act]
  - Non-Banking Financial Co. (as defined in RBI Act, 1934)
  - Housing Finance Co. (registered with National Housing Bank) established under NHB Act, 1987 ) [New Exclusion]
  - Co. specified by CG under proviso to 73(1) [none so far]

# Deposit defined



Section 2 (31) Definition modified

“deposit” includes any receipt of money by way of deposit or loan or in any other form, by a company, but does not include *such categories of amount as may be prescribed in consultation with RBI\**

\*- Definition as per *Companies (Acceptance of Deposits) Rules, 2014*



# Acceptance of Deposit

A company may accept deposits from its members subject to:

- resolution in general meeting
- rules as may be prescribed in consultation with RBI\*
- terms & conditions agreed between Co & its members
  - provision of security (if any)
  - Repayment term
  - Interest rate



# Deposit from members (conditions)



- circular to its members
  - financial position
  - credit rating
  - total number of depositors
  - Amt. due towards deposits of previous deposits
  - such other particulars in such form and in such manner as may be prescribed
- filing the above with ROC within 30 days before its issue
- Depositing not less than 15% maturing during two FY - separate bank account of a scheduled - deposit repayment reserve account
- Insurance as may be prescribed

# Deposit from members (conditions)



- Certification -no default in the repayment of deposits & interest  
- before or after the commencement of this Act
- providing security, if any and creation of charge on the property or assets of the company

## *Proviso*

*In case of unsecured or partially secured deposits – such shall be so quoted in all documents, circulars etc.*

# Deposit from members (conditions)



- repaid with interest in accordance with the terms and conditions
- Failure - the depositor may apply to the NCLT repayment or for any loss or damage
- Deposit repayment reserve account not be used for any purpose other than repayment of deposits.



# Deposit not to include (Rules)

- any amount received from or source is guaranteed by CG or SG
- received from foreign Govt., foreign banks, FI etc.
- loan or facility from any banking company, FI
- **any amount received from any other company**
- Share/security subscription money - pending allotment – to be used for allotment only
  - Allotment within 60 days – otherwise deposit (15 days)
  - No adjustment for any other purpose allowed
- any amount received from a director of the company
  - declaration in writing



# Deposit not to include (Rules)

- any amount raised by the issue of compulsorily convertible secured bonds or debentures against first charge of the FA (other than intangible) – convertible within five years
- any amount received from an employee of the company not exceeding his annual salary
- any non-interest bearing amount received or held in trust
- any amount brought in by the promoters of the company by way of unsecured loan in pursuance of the stipulation of any lending financial institution or a bank subject to fulfillment of certain conditions





# Deposit not to include (Rules)

- any amount received in the course of, or for the purposes of, the business of the company
  - Advance for supply of goods or services within 365 days from date of deposit
  - advance against the property in accordance with the terms of agreement or arrangement
  - as security deposit for the performance of the contract for supply of goods or provision of services
  - as advance received under long term projects for supply of capital goods

*Permission in dealing in those goods & services*



## Deposits prior to commencement of this Act

- Section 74
- Filing with ROC within 30 days (extended upto August 31, 2014)
- Repay within one year
- NCLT may allow certain relaxations based on financial condition of the company (sub section notified on June 6, 2014)
- Failure to repay interest & deposit amount - punishable
  - Fine for company – Rs. 1cr to Rs.10 cr
  - Imprisonment for officer in default upto 7 years and/or fine
  - (sub section notified on June 6, 2014)



# Damages for Fraud

- Section 75 {New Section} (not notified yet)
- After extension by NCLT, intent to defraud the depositors is proved then section 447 would apply
- Officer in default personally liable for losses or damages
- Class Action possible also



# Acceptance of Deposits by certain companies

- Section 76 {New Section}
- Eligible Companies (every public co) under Rules can accept deposits from Public
  - New Worth of > Rs.100 cr
  - Turnover > Rs.500 cr
  - Prior consent in general meeting by **special** resolution
  - Filing with ROC before acceptance
  - Ordinary resolution if within limits specified u/s 180 (1) (c)
- Requirement to obtain credit rating, annually
- Create a charge on assets within 30 days



## Terms & Conditions of acceptance (Rule 3)

- Acceptance for between 6 and 36 month
- Acceptance for less than 6 months subject to
  - Not exceeding 10% of paid up capital + Free Reserves
  - Not earlier than 3 months
- 'Jointly', 'either or survivor', 'anyone or survivor' etc.
- Deposits from members - Aggregate deposits cannot exceed 25% of paid up capital + Free Reserves of company



## Limit on Eligible companies

- Eligible company shall accept or renew any deposit:
  - From members < 10% of paid up capital + free reserves
  - Other deposits < 25% of paid up capital + free reserves
- *Such deposits together with outstanding deposits on the date of acceptance or renewal*
- Government company eligible to accept deposits – not exceeding 35% of the aggregate of its paid up share capital + free reserves

# Terms & Conditions of acceptance (Rule 3)



- Deposits from members & public - Maximum interest rate & brokerage regulated by RBI
- Alteration in terms and conditions (prejudice or disadvantage of the depositor) not possible



# Punishment for contravention (76A)

- The company shall, in addition to the payment of the amount of deposit or part thereof and interest due, be punishable with fine which shall not be less than 1 crore but may extend to 10 crore.
- Every officer of the company who is in default shall be punishable with imprisonment which may extend to seven years or with fine which shall not be less than twenty-five lakh rupees but which may extend to two crore rupees, or with both:
- Provided that if it is proved that the officer of the company who is in default, has contravened such provisions knowingly or willfully with the intention to deceive the company or its shareholders or depositors or creditors or tax authorities, he shall be liable for action under section 447.”.
- **As per Companies’ Amendment Bill dated December 17, 2014**



# Net Worth



Section 2(57) Definition is modified

“net worth” means the aggregate value of the paid-up share capital and all reserves created out of the profits and securities premium account, after deducting the aggregate value of the accumulated losses, deferred expenditure and miscellaneous expenditure not written off, as per the audited balance sheet, but does not include reserves created out of revaluation of assets, write-back of depreciation and amalgamation;

# Free Reserves



Section 2(43) Definition is modified

“free reserves” means such reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend;

Provided that:

- i. any amount representing unrealised gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or
- ii. any change in carrying amount of an asset or of a liability recognised in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value,

shall not be treated as free reserves

# Turnover



## Section 2(91) New Definition

“turnover” means the aggregate value of the realisation of amount made from the sale, supply or distribution of goods or on account of services rendered, or both, by the company during a financial year.



# Other Rules for acceptance of Deposits

- Rules for companies cos u/s 73 (2) & eligible cos
- Forms to be used & Advertisements
- Manner & extent of deposit insurance (extended upto March 31, 2015)
- Creation of security & Charge
- Appointment of trustees & their duties
- Maintenance of registers of depositors
- Maintenance of liquid assets and creation of Deposit Repayment Reserve Account
- Penal Interest
- Other matters





## Important Takeaways

- Maximum allow ability of 365 days
- ICD allowed
- Share application money – allotment within 60 days
- Secured (only against FA) convertible Debentures allowed - maximum period 5 years
- NBFCs & Banks out of Chapter V
- Deposits from members subject to sec 73 (2)
- Eligible cos – deposits from public
- Limit on deposits by Govt. Companies
- Deposits in normal course of business – 365 days



# Comparison

- **Companies Act 1956:**
  - Deposits / loans can be accepted from directors, members and relatives.
  - Inter-corporate deposits (ICDs) permissible
- **Companies Act 2013:**
  - Exemption for deposits from directors (from own funds)
  - Deposits from members (incl. by private companies) only upto 25 % of paid up share capital and free reserves
  - Share application money received – shares to be allotted within 60 days else refunded
  - Advances in course of business for supply of goods / services – only upto 365 days from receipt
  - Amounts brought by promoters as per bank stipulations



# Acceptance of Loans/Deposits ...

- **For existing deposits as on 1st April 2014:**
  - Statement to be filed for deposits accepted and remaining unpaid
  - Repay all such deposits as and when they become due or within 1 year whichever is earlier
  - Application to be made to NCLT for extension in above
- **Impact on Private Companies**
  - No blanket exemption for deposits from shareholders and relatives
  - Liquidity constraints for repayment of existing deposits within 1 year
  - Stringent penalties for non-compliance
  - Greater director (and auditor) responsibility



What happened  
Sharma Ji??



I lost my money  
in Company Fixed  
Deposit







# Provisions Regarding

# Loans to Directors [Sec185 Chapter XII]





## Loans to Directors (section 185)

- Corresponding to s 295 & 296 of old act
- Save as otherwise provided in this Act, no company shall, directly or indirectly, advance any loan, including any loan represented by a book debt, to any of its directors or to any other person in whom the director is interested or give any guarantee or provide any security in connection with any loan taken by him or such other person
- - *Section already operational from 12th Sept 2013*



## Loans to Directors (exemptions)

- Loan to managing or whole time director
  - as a part of the conditions of service extended by the company to all its employees
  - pursuant to any scheme approved by the members by a special resolution
- a company which in the ordinary course of its business provides loans or gives guarantees or securities for the due repayment of any loan and in respect of such loans an interest is charged at a rate not less than the bank rate declared by the Reserve Bank of India



## Bill 185 of 2014 – not yet notified

- Provisos to be added
  - any loan made by a holding company to its wholly owned subsidiary company or any guarantee given or security provided by a holding company in respect of any loan made to its wholly owned subsidiary company
  - any guarantee given or security provided by a holding company in respect of loan made by any bank or financial institution to its subsidiary company
  - Provided that the loans made under clauses (c) and (d) are utilised by the subsidiary company for its principal business activities



## “any other person in whom director is interested”

- any director of the lending company, or of a company which is its holding company or any partner or relative of any such director;
- any firm in which any such director or relative is a partner;
- **any private company of which any such director is a director or member;**
- any body corporate at a general meeting of which not less than twenty five per cent. of the total voting power may be exercised or controlled by any such director, or by two or more such directors, together; or
- any body corporate, the Board of directors, managing director or manager, whereof is accustomed to act in accordance with the directions or instructions of the Board, or of any director or directors, of the lending company.



## Loans to directors

- If any loan is advanced or a guarantee or security is given or provided in contravention
- company shall be punishable
  - fine between 5 to 25 lacs
- director or the other person shall be punishable
  - imprisonment maximum six months
  - fine 5 to 25 lacs
  - or both



## Definition of Relative

- Sec 2(77) - “**relative**”, with reference to any person, means anyone who is related to another, if—
  - (i) they are members of a Hindu Undivided Family;
  - (ii) they are husband and wife; or
  - (iii) one person is related to the other in such manner as may be prescribed\*;

\*- Father, mother, son, son’s wife, daughter, daughter’s husband, brother, sister, (including step relations)



## Exemptions (1<sup>st</sup> April 2014)

- Any loan made by a holding company to its wholly owned subsidiary company or any guarantee given or security provided by a holding company in respect of any loan made to its wholly owned subsidiary company
- Any guarantee given or security provided by a holding company in respect of loan made by any bank or financial institution to its subsidiary company
- *Provided that such loans made are utilized by the subsidiary company for its principle business activities.*





## Applicability to Private Limited Companies:

- As per draft notification issued u/s 462 (as available on MCA website) – Sec 185 shall not apply to private companies:
  - Which have borrowings from banks or financial institutions or any bodies corporate not more than twice of their paid up share capital or Rs 50 crores whichever is lower AND
  - In whose share capital no other body corporate has invested money AND
  - No pending default



## Takeaways

- **No distinction between Private & Public company**
- Loans given before 12-Sep-13??
- What happens to loans between 12-Sept and 31-March ?
- Even if a loan etc. obtained in contravention of the above provisions is repaid, the contravener would still be exposed to punishment by way of imprisonment
- applicable prospectively and should not affect existing loans etc.
- renewals of loan etc. needs to be in conformity with the 2013 Act
- **Section does not contain any remedial proviso**



## Issues & solutions:

- What happen to existing loans?
- Loans between September and March?
- Can a subsidiary give a loan to Holding Co?
- Shares held by directors as “nominee”
  
- Rearrange or realign – shareholding and/or directorship
- Appoint new directors
- Convert to LLP
- Use of dependent relatives





# Provisions Regarding

# Loans and Investments [Sec186 Chapter XII]





## Loans and Investments

- Sec 186 {corresponds to sec 372A of Old Act}
- Without prejudice to the provisions contained in this Act, a company shall unless otherwise prescribed, make investment through not more than two layers of investment companies:
- Exemptions
  - acquiring any other company incorporated outside India if such other company has investment subsidiaries beyond two layers as per the laws of such country;
  - Required under any law or under any rule or regulation framed under any law for the time being in force.



# Loans and Investments

- No company shall directly or indirectly:
  - give any loan to any person or other body corporate;
  - give any guarantee or provide security in connection with a loan to any other body corporate or person; and
  - acquire by way of subscription, purchase or otherwise, the securities of any other body corporate
- Limits
  - exceeding 60% of its paid-up share capital + free reserves + securities premium account or
  - 100% of its free reserves + securities premium account,
  - Whichever is more
- Excess of limit: prior approval by a special resolution at a general meeting shall be necessary

# Loans & Investments other conditions



- Disclosure to the members in the financial statement with full particulars
- Approved at BOD by all the directors and prior approval of public financial institution,
  - approval for Fi not required, if within the limits & no default in repayment
- rate of interest cannot be lower than the prevailing yield of 1/3/5/10 year GSec closest to the tenor of the loan
- Defaulting in repayment of deposits cannot give loans, till such default continues
- Exemptions to
  - NBFC registered with RBI, Banking, insurance Housing Finance or any co engaged in the business of providing loans or Providing infrastructural facilities
  - For acquisition made by a co – principal business is acquisition of securities
- Maintenance of register & open for inspection at RO



# Loans & Investments other conditions



- Penalty
- If a company contravenes the provisions of this section, fine between Rs.25,000 to Rs.500,000
- officer in default
  - imprisonment to two years and
  - fine between Rs.25,000 to Rs.100,000

# Explanation.—For the purposes of this section



- “investment company” means a company whose principal business is the acquisition of shares, debentures or other securities
- “infrastructure facilities” means the facilities specified in Schedule VI

# Loans and Investments certain issues...



- Securities – defined under 2 (81) - means the securities as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956-
  - To include shares, bonds, stocks, debentures, warrants or other marketable securities of a similar nature offered by a corporate body
- Sec 2(11) “body corporate” or “corporation” includes a company incorporated outside India, but does not include—
  - a co-operative society registered under any law relating to co-operative societies; and
  - any other body corporate (not being a company as defined in this Act), which the Central Government may, by notification, specify in this behalf;

# Loans and Investments certain issues...



- “body corporate”
  - Mutual Fund structured as a trust – would not be covered
  - LLP???
- Definition of Paid up capital, Free reserves and meaning of Securities Premium

# Paid-up share capital



## Section 2(64) New Definition

“paid-up share capital” or “share capital paid-up” means such aggregate amount of money credited as paid-up as is equivalent to the amount received as paid up in respect of shares issued and also includes any amount credited as paid-up in respect of shares of the company, but does not include any other amount received in respect of such shares, by whatever name called;

# Free Reserves



Section 2(43) Definition is modified

“free reserves” means such reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend;

Provided that:

- i. any amount representing unrealised gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or
- ii. any change in carrying amount of an asset or of a liability recognised in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value,

shall not be treated as free reserves

# Securities Premium



## Section 52

Where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount of the premium received on those shares shall be transferred to a “securities premium account”

# Loans and Investments beyond limits



- Lending/investor company to seek prior approval of shareholders by a special resolution at a general meeting.
- Lending/investments in WOS are exempt from above prior approval





# Rules also provide



- Provisions of sec 186 shall not apply where loan/guarantee/security has been provided to its WOS/JV/acquisition made by way of subscription, purchase or otherwise.
- Where the loans and investments made exceeds the limits specified u/s 186 special resolution is passed within one year from the date of notification of this section





# Layers of Investment Companies

- New Concept
- Only for investment companies –
- Operating cos – seems to be no problem
- Maximum two layers of investment companies
- “investment company” means a company whose principal business is the acquisition of shares, debentures or other securities
- Investments in all classes of assets covered – like land etc.
- Partnership firm, LLP may not be covered as investment companies?????
- Debate on principal business

# Layers of Investment Companies





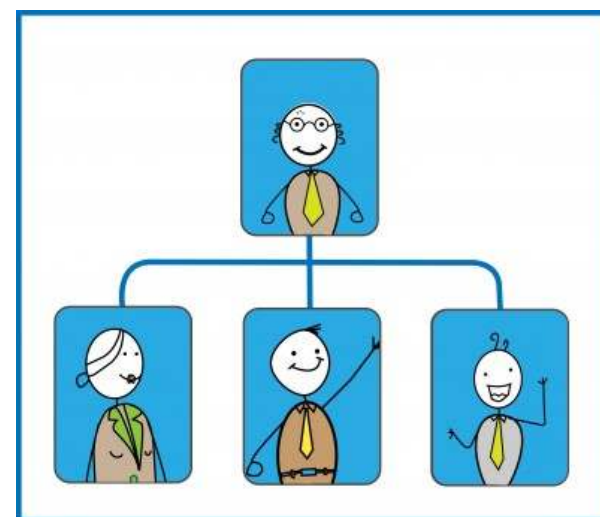
# Changes from Sec 372A

- Companies prohibited from making investments through more than 2 layers of investment companies except:
  - Overseas investee having more than 2 layers as per local laws
  - Where large no of layers is required to meet any law/rule/regulation.
- Regarding the limits –
  - Loans to persons other than bodies corporate to be also included
  - Limits also cover loans made/guarantees or security given by a private company.
  - Loans/guarantee/security for a joint venture company is excluded from the limits.
- Disclosures in FS regarding loans/guarantees/security, including proposed utilisation.
- Rate of Interest on loans to be not less than prevailing yield on 1/3/5/10 year government security (closest to loan's tenure) – presently bank rate.



# Provisions Regarding

# Related Party Transactions [Sec188 Chapter XII]



# Related Party Transactions (RPT)



Identification of Related Parties

Related Party transactions

Approval process

Disclosure requirements

# Identification of Related Parties



Accounting  
Standard 18

*Section  
40A(2)(b) of  
Income Tax Act*

*Domestic  
Transfer Pricing*

Revised Clause  
49 of Listing  
Agreement

**Companies  
Act 2013**

# Related Party



- Sec 2 (76) “related party” with reference to a company, means —
  - director or his relative;
  - KMP or his relative;
  - firm, in which a director, manager or his relative is a partner;
  - private company in which a director or manager or his relative is a member or director ;
  - 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 BoD, MD, or manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager;
  - any person under whose advice, directions or instructions a director or manager is accustomed to act;
  - any company which is —
    - a holding, subsidiary or an associate company of such company; or
    - a subsidiary of a holding company to which it is also a subsidiary
  - such other persons as may be prescribed (director, KMP of the holding company or his relative to be deemed a related party)





## Definition of Relative

- Sec 2(77) - “**relative**”, with reference to any person, means anyone who is related to another, if—
  - (i) they are members of a Hindu Undivided Family;
  - (ii) they are husband and wife; or
  - (iii) one person is related to the other in such manner as may be prescribed\*;

\*- Father, mother, son, son’s wife, daughter, daughter’s husband, brother, sister, (including step relations)



## Definitions

- Sec 2(51) - “**key managerial personnel**”, (KMP) in relation to a company, means -
  - Chief Executive Officer or the managing director or the manager
  - company secretary
  - whole-time director
  - Chief Financial Officer; and
  - such other officer as may be prescribed
  - *A Whole time KMP shall not hold office in more than 1 company at the same time*

*(New Definition)*

# Private Company



Section 2(68) Definition is modified

“private company” means a company having a minimum paid-up share capital ~~of Rs.1 Lakh or such higher paid-up share capital~~ as may be prescribed, and which by its articles, -

- i. Restricts the rights to transfer its shares;
- ii. Except incase of one person company, **limits the number of its members to 200;** and
- iii. *Prohibits any invitation to the public to subscribe for any securities of the company.*



# Subsidiary Company

Section 2(87) Definition is modified

“subsidiary company” or “subsidiary”, in relation to any other company (that is to say the holding company), means a company in which the holding company—

- i. controls the composition of the Board of Directors; or
- ii. exercises or controls more than one-half of the total share capital either at its own or together with one or more of its subsidiary companies

***Total share capital would mean Paid up Eq Sh Cap + convertible Pref. Sh.***

Provided that such class or classes of holding companies as may be prescribed shall not have layers of subsidiaries beyond such numbers as may be prescribed.



## Definition

- Sec 2(6) - “**associate company**”, in relation to another company, means a company in which that other company has a significant influence, but which is not a subsidiary company of the company having such influence and includes a joint venture company.
- Explanation.—For the purposes of this clause, “significant influence” means control of at least twenty per cent. of total share capital, or of business decisions under an agreement

*(New Definition)*



# Related Party

**Issue - X Ltd and Y Ltd are two public companies. Mr. A is a director on the board of X Ltd and Y Ltd. Wife of Mr. A holds more than 2% share capital in Y Ltd. Besides this there is no relationship between two companies. Will X Ltd and Y Ltd be Related Parties?**

**Each company will perform its own independent evaluation.**

**View :**

**For X Ltd , Y Ltd is a related party since:**

- Y Ltd is a public company in which the Mr. A is a director **and** holds along with relatives more than 2% of its paid up share capital.

**For Y Ltd, X Ltd is not a related party since:**

- Mr. A is a director but does not hold more than 2% of its paid up share capital.



# Related Party

**Issue – Same facts except X Ltd is a private company.**

**Comment whether X Ltd and Y Ltd are Related Parties.**

## **View:**

**For X Ltd , Y Ltd is a related party since: No change**

- Y Ltd is a public company in which the Mr. A is a director **and** holds along with relatives more than 2% of its paid up share capital.

**For Y Ltd, X Ltd is a related party since:**

- X Ltd is a private company, a 'related party' means a private company in which a director/manager is a member or director. Mr. A is a director in both companies.

# COVERAGE OF RELATIVE



Cases of Relative	Co. Act, 1956	Co. Act, 2013	IT Act, 1961	Cases of Relative	Co. Act, 1956	Co. Act, 2013	IT Act, 1961
Members of HUF	Yes	Yes	Yes	Mother's father	Yes	No	No
Husband/Wife	Yes	Yes	Yes	Son's son/ daughter	Yes	No	Yes
Father (including step-Father)	Yes	Yes	Yes	Daughter's husband	Yes	Yes	Yes
Mother (including step-mother)	Yes	Yes	Yes	Son's daughter's husband	Yes	No	No
Son (including step-son)	Yes	Yes	Yes	Daughter's son	Yes	No	No
Daughter (including step-daughter)	Yes	Yes	Yes	Daughter's Son's wife	Yes	No	No
				Son's son's wife			Yes
Brother (including step-brother)	Yes	Yes	Yes	Daughter's daughter	Yes	No	No
Sister (including step-sister)	Yes	Yes	Yes	Daughter's daughter's husband	Yes	No	No
Son's Wife	Yes	Yes	Yes	Son's daughter's husband	Yes	No	No
Father's father	Yes	No	Yes	Daughter's son's wife	Yes	No	No
Father's mother	Yes	No	Yes	Brother's wife	Yes	No	Yes
Mother's mother	Yes	No	No	Sister's husband	Yes	No	Yes



# Related Party Transactions (RPT)



- Except with the consent of the BOD 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—
  - 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
  - underwriting the subscription of any securities or derivatives thereof, of the company



## Approvals required for RPT

- A transaction with a related party is (i) not in the ordinary course of business or (ii) is in the ordinary course of business but not on an arm's length basis:
  - Prior consent of the BOD by a resolution at a board meeting and subject to such conditions as may be prescribed
  - Prior approval of the shareholders where paid-up capital of company or transaction amount exceeds prescribed limit - ~~special~~ resolution
- Related party who is a member of such a company cannot vote on such a ~~special~~ resolution



## The Companies (Amendment) Bill, 2014

- Prior Approval of shareholders at the general meeting – not required if-
  - transactions entered into between a holding company and its wholly owned subsidiary whose accounts are consolidated with such holding company and placed before the shareholders at the general meeting for approval



## Prior consent of the BOD

- A company shall enter into any contract or arrangement with a related party subject to the following conditions, namely:
  - The agenda of the Board meeting at which the resolution is proposed to be moved shall disclose-
    - name of the related party and nature of relationship
    - the nature, duration of the contract and particulars of the contract or arrangement;
    - the material terms of the contract or arrangement (incl. value)
    - any advance paid or received for the contract
    - the manner of determining the pricing and other commercial terms
    - 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
    - any other information relevant or important for the Board to take a decision on the proposed transaction.
- Interested director not to be present during discussion



## Prior approval of Members

- A company having paid up share capital > Rs. 10 cr
  - sale, purchase or supply of any goods or materials > 25% of Turnover
  - selling or otherwise disposing of, or buying, property of any kind > 10% of Net worth
  - leasing of property of any kind > 10% of Net worth
  - availing or rendering of any services > 10% of Net worth
  - appointment of any agent for purchase or sale of goods, materials, services or property
  - relates to appointment to any office or place of profit in the company, its subsidiary company or associate company at a monthly remuneration exceeding 2.50 lakh; or
  - is for a remuneration for underwriting the subscription of any securities or derivatives thereof of the company exceeding 1% of Net worth
- Interested members not to vote



## Prior approval of Members

- The Turnover or Net Worth referred in the above sub-rules shall be on the basis of the Audited Financial Statement of the preceding Financial year
- 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
- The explanatory statement to be annexed to the notice of a general meeting convened pursuant to section 101 shall contain the necessary particulars



## Audit Committee Approval

- A company needs approval of the Audit Committee, if applicable, for all RPT and subsequent modifications thereto
- *This is irrespective of whether they are in the ordinary course of business or at arm's length or breaching share capital/transaction threshold values*



## Some Issues

- What is meant by ‘ordinary course of business’?
  - Not defined in the Act
- Methodologies/Approaches to be used for identifying whether a related party transaction has been entered into on an ‘arms’ length basis’?
  - Can a Co use the methodologies/approaches under other statutes e.g. – Income tax Act? Transfer Pricing ?





## Ordinary Course Of Business

- Not defined in the Act
- Guidance from Standard on Auditing (SA) 550 Related Parties
- Examples of transactions outside normal course of business may include.
  - Equity transactions, M&A, corporate restructurings or acquisitions.
  - Sales of goods/services with unusually large discounts or returns
  - Rendering of services without (inadequate) consideration is exchanged
  - Transactions with circular arrangements, for example, sales with a commitment to repurchase.
  - Transactions under contracts whose terms are changed before expiry



## Arm's Length Transaction

- the expression “**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.
- Management is responsible for the substantiation of arm's length transaction
  - External expert to determine a market value and other terms and conditions
  - Comparing with similar transaction with one or more unrelated parties
  - Similar transactions on an open market
  - Public data available
  - Evaluating the reasonableness



## Arm's Length Transaction

- Some Challenges
  - Not an arithmetic formula
  - Derived numbers based on assumptions
  - Conflicting positions under different statutes (Customs, IT, TP etc.)
  - Many a times worked out backwards
  - No precedents
  - In case not accepted by tax authorities



## Explanations

- “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



## Other provisions

- Board Report to contain mention of every contract or arrangement entered with RP along with the justification for entering into such contract or arrangement
- contract with RP without prior approval to be ratified by BOD/general members within 3 months - else invalid – director to indemnify the company
- Company to recover loss against any such party in case of loss sustained due to contract
- Punishable offence with fine for listed co & other cos.



## Disclosure Requirements

- Sec 188 (2) requires that every contract/arrangement entered u/s 188(1) to be referred to in the Board Report along with justification.
- Explanatory statement annexed to the notice to contain the following:
  - Name and nature of relationship,
  - Name and nature of director/KMP who is related
  - Material terms of the contract or arrangement;
  - Any other information that maybe relevant for to take a decision.



## Takeaway - Related Party Transactions (RPT)

- Member approval instead of CG approvals
- Related party to be excluded from voting
- ~~Special resolution – 75% from non related~~
- ~~Majority approval from minority through special resolutions –  
Operational difficulty, possible loss of objectivity~~
- arms' length price will call for aligning the benchmarking under transfer pricing norms as per Income tax Act for both domestic and international transactions
- Property (including lease) also covered
- Justification to be provided in BOD report for related party transaction – more onus on BOD



## Applicability to Private Limited Companies

- As per draft notification issued u/s 462 (as available on MCA website) – section 188 would not apply to private companies





*Thank you*