

Companies Act 2013

- ❖ **Related party transactions**
- ❖ **Inter-corporate Loans and Advances**
- ❖ **Restriction for Acceptance of Deposits**

June 21, 2014



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Related parties - Identification

'Related Parties' – S. 2 (76)

Related Party with reference to a company means:
Director / KMP or their relatives. <ul style="list-style-type: none">▶ As per Rule 2e of Chapter XII - The Companies (Meetings of Board and its Powers) Rules, 2014 'Related Party' means a director or key managerial personnel of the holding company or his relative
A firm in which a director, manager or his relative is a partner
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 and holds along with his relatives more than 2% of its paid up share capital
Any body corporate whose Board of Directors, managing director or manager is accustomed to act in accordance with advice, directions, or instructions of a director or manager *
Any person on whose advice, directions or instructions a director or manager is accustomed to act *
A holding company
A subsidiary company
An associate company
A fellow subsidiary

** Will not apply to advice, directions or instructions given in a professional capacity*

'Relatives' – S. 2 (77)

Relative with reference to any person means:

Members of HUF	Son (including step-son)
Husband/ wife	Son's wife
Father (including step father)	Daughter
Mother (including step-mother)	Daughter's husband
Sister (including step-sister)	Brother (including step-brother)

As per Revised clause 49 of Equity Listing Agreement the term 'relative' shall mean 'relative' as defined in section 2(77) of the Companies Act , 2013 and rules prescribed there under.

Governance**Accounting****Audit****Who are related parties ?**

Nature of relationships	Act	AS 18
KMP and relatives	Yes	Yes
Holding, subsidiary, associate, Joint venture	Yes#	Yes
Individuals holding >20% and their relatives in a Co	Yes ***	Yes
Directors and their relatives	Yes	No *
Entities with common KMP	Yes**	Yes
Director or relative is a partner in a Firm	Yes	No
Body Corporate – Accustomed to act in accordance with Director/KMP	Yes	No##
Any person under who directions directors/KMP act	Yes	Yes##
Director / KMP (or relative) of Holding, subsidiary or associate	Yes	No
Members of Core Management Team (other than BoD)	Yes	No

*Only if they are able to affect policies of both enterprises

** Only if KMP is a director

*** Sufficient for director, KMP to be a member or director or hold 2% in public co. But a shareholder individual who is not a KMP or Director is not RPT for the Act but for AS 18

Joint venture not covered in Act for RPT

Only if control or significant influence is proved

'Related Party' – SEBI Revised Clause 49

Related Party

A 'related party' is a person or entity that is related to the company. Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party, directly or indirectly, in making financial and/or operating decisions and includes the following:

1. A person or a close member of that person's family is related to a company if that person:

a. Is a related party under Section 2(76) of the Companies Act, 2013; or

b. has control or joint control or has significant influence over the company; or

c. is a key management personnel of the company or of a parent of the company;

OR

2. An entity is related to a reporting entity if any of the following conditions applies:

a. The entity is a related party under Section 2(76) of the Companies Act, 2013.

b. The entity and the company are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others)

c. One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).

d. Both entities are joint ventures of the same third party.

e. One entity is a joint venture of a third entity and the other entity is an associate of the third entity.

f. The entity is a post-employment benefit plan for the benefit of employees of either the company or an entity related to the company. If the company is itself such a plan, the sponsoring employers are also related to the company.

g. The entity is controlled or jointly controlled by a person identified in (1)

h. A person identified in (1)(b) has significant influence over the entity (or of a parent of the entity).

A photograph of a desk with a stack of sticky notes. The top note is grey, and the others are yellow. A green pencil is lying on the desk to the right. A yellow banner is overlaid on the bottom left of the image.

Covered Transactions

Covered transactions

As per S. 188 (1) of Companies Act, 2013:

- (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

Revised Clause 49 (VII) (A) :

A related party transaction is a transfer of resources, services or obligations between a company and a related party, regardless of whether a price is charged

A photograph of a desk with a stack of sticky notes. The top note is grey, and the others are yellow. A green pencil is lying on the desk to the right. A yellow banner is overlaid on the bottom left of the image.

Ordinary Course of Business

Transactions not in the ordinary course of business

Key aspects to be considered in evaluating whether a transaction is not in the ordinary course of business:

- ▶ Whether the transaction is covered in the main objects or object incidental to the main objects as envisaged in the Memorandum of Association;
- ▶ Whether a transaction is usual or unusual;
- ▶ Frequency;
- ▶ Whether transaction is done at arm's length;
- ▶ Whether transaction is done on similar basis with other third parties;
- ▶ Business purpose of the transaction;
- ▶ Size and volume of transaction.

Transactions not in the ordinary course of business* - Illustrative

Complex equity transactions, such as corporate restructurings or acquisitions

Transactions with offshore entities in jurisdictions with weak corporate laws

Sales transactions with unusually large discounts or returns

Transactions with circular arrangements, for example, sales with a commitment to repurchase

Transactions under contracts whose terms are changed before expiry

The leasing of premises or the rendering of management services by the entity to another party if no consideration is exchanged

**Transactions outside the entity's normal course of business basis Guidance from Standard on Auditing (SA) 550 Related Parties*



Arm's Length Pricing

Arm's length principle

- ▶ 'Arm's length principle' - The international standard for determining transfer pricing for tax purposes
 - ▶ A related party transaction to be priced at a level, at which unrelated parties would undertake 'similar' transactions under 'similar' conditions
- ▶ Companies Act, 2013 does not prescribe methods for determining arm's length price ('ALP')
- ▶ Indian Transfer Pricing ('TP') regulations prescribe six methods for determination of ALP
 - ▶ Prescribed TP methods could serve as useful tools
 - ▶ Flexibility to adopt methods and take guidance from international best practices
- ▶ Differentiated approach to ALP determination:
 - ▶ Routine vs. non routine transactions
 - ▶ High value transactions
 - ▶ Transactions outside the entity's 'ordinary course of business'

A photograph of a desk with a stack of papers and sticky notes. The top paper is grey, and the sticky notes are yellow. A green pencil is visible in the background. A yellow diagonal banner is overlaid on the bottom left of the image.

Approval of Related Party Transactions

Covered transactions – Special resolution thresholds

- Paid up share capital threshold – Rs 10 crores or more
- Transaction value threshold :
 - (a) Sale, purchase or supply of any goods or materials - > 25% of Annual Turnover
 - (b) Selling or otherwise disposing of, or buying, property of any kind - > 10% of NW
 - (c) Leasing of property of any kind - >10% of NW or 10% of Turnover
 - (d) Availing or rendering of any services - > 10% of NW
 - (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 – Remuneration > Rs 2.50 lacs pm
 - (g) Underwriting the subscription of any securities or derivatives thereof, of the company – Remuneration > 1 % of NW



Disclosures

Disclosures

Disclosure as per Companies Act 2013 in the Board Report

- ▶ S. 188 (2) – every contract / arrangement entered under S. 188 (1) shall be referred to in the Board Report along with justification.

Disclosure as per Revised Clause 49

- ▶ Policy on dealing with related parties on its website and in the annual report
- ▶ Details of material related party transactions on a quarterly basis along with the compliance report on corporate governance
- ▶ Disclosure by senior management to the Board of all material financial and commercial transactions where they have a personal interest that may have a potential conflict with the interest of the company

Disclosure as per AS 18

- ▶ Name of the related party
- ▶ Nature of the relationship
- ▶ Description of the nature of the transactions
- ▶ Volume of the transactions either as amount or as appropriate proportion
- ▶ Any other elements necessary for understanding the financial statements
- ▶ Amounts outstanding and provision for doubtful debts
- ▶ Amounts written off or written back
- ▶ Remuneration paid to KMPs

Related Party Transactions – Next Steps

Related Party Transactions

- ▶ Need to identify all related parties as per definition given in the Act (RPT disclosures in the financials can be starting point) and list down transactions with related parties as per section 188 (1)
- ▶ Transactions entered on or before March 31, 2014 but not completed needs to be covered
- ▶ Approval of Board by a resolution in meeting is required for all transactions covered u/s 188(1) with related parties (within 3 months need to be ratified)
- ▶ Need to evaluate and document that transactions are in ordinary course of business and basis for concluding arm's length
- ▶ Special resolution of shareholders (other than shareholders which are related party) is required if not in ordinary course of business and not arm's length
- ▶ All transactions to be reported to shareholders in Board report (refer format given in Form No. AOC-2). If transactions are not arm's length, justification to be given for entering into such transactions.

A photograph of a desk with a stack of papers, sticky notes, and a pencil. The papers are stacked in the background, with a stack of grey papers on top of yellow sticky notes. A green pencil is lying on the desk to the right. In the foreground, a white sticky note is partially visible with some faint handwriting. The scene is lit with soft, natural light, creating a professional and organized atmosphere.

Inter Corporate Loans and Advances

Loans to Directors and Subsidiaries

Loans to directors - Section 185

- ▶ Section 185 - 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 (includes any body corporate, where MD / Manager or BOD is accustomed to act in accordance with the directions or instructions of the Board, or of any director or directors, of the lending company) or give any guarantee or provide any security in connection with any loan taken by him or such other person
- ▶ 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 is exempted from the requirements under this section and 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 is exempted from the requirements under this section. Provided that such loans made) are utilised by the subsidiary company for its principle business activities.

Loans / Investment by Company

- ▶ Cannot make more than 2 layers of investment companies except acquiring existing company based out of India if such other company has investment subsidiaries beyond two layers as per the laws of such country
- ▶ Approval of the members by means of a special resolution required if loans/ guarantees/security to other corporate or acquiring securities of other corporate exceeding higher of :
 - ▶ 60% of paid up capital, free reserves and securities premium or
 - ▶ 100% of free reserves and securities premium
- ▶ Section 185 does not permit loan to be given to directors or any company in which director is interested (includes any body corporate, where MD / Manager or BOD is accustomed to act in accordance with the directions or instructions of the Board, or of any director or directors, of the lending company)
- ▶ The rate of interest should not be lower than the prevailing yield of 1 year, 3 year, 5 year or 10 year Government Security closest to the tenor of the loan.
- ▶ The Company shall also have to disclose in the financial statements the full particulars of the loan and also the purpose for which the loan is proposed to be utilised by the recipient of the loan.

A photograph of a stack of sticky notes on a reflective surface. The top note is grey, and the others are yellow. A green pencil is visible in the background. A yellow triangular graphic is overlaid on the bottom left.

Restrictions on Acceptance of Deposits

Restrictions on Acceptance of Deposits

- ▶ No Company shall invite, accept or renew deposits from the public except as provided in the Act
- ▶ This shall not apply to a banking company and NBFC
- ▶ Company may, subject to resolution in a general meeting and prescribed Rules accept deposits from its members
- ▶ Companies (Acceptance of Deposits) Rules 2014 notified.



Thank you