

# Related Party Transactions

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# What's on today's Agenda?

2

- What are 'related parties',
- What are 'transactions',
- What is Ordinary Course of Business under Cos. Act, 2013,
- What is Arms length basis under Cos. Act, 2013,
- RPTs under SEBI Regulations ,
- What are the pricing parameters under SEBI Regulations,
- Audit Committee approval for RPTs,
- Board Approval for RPTs,
- Shareholders approval for RPTs,
- Cost Audit perspective of RPTs.

# Disclaimer

*Cos., Directors & their transactions are referred to as samples, without knowing the exact details and knowing the precise terms and conditions of the proposed transaction / understanding.*

# Sample RPTs

4

- *Mrs. AA is Director of T Ltd. Co. proposes to appoint Mrs. AA's daughter as Director,*
- *Mr. AK is promoter & director K Ltd. & A Ltd. Both Cos. propose to enter into a transaction (say – sale of goods)*
- *Mr. B Bajaj is Director in B Insurance Co. Ltd. He proposes to take Health Insurance Policy of B Insurance Co. Ltd.*

## ... Sample RPTs

5

- *TM Ltd. proposes to raise capital by making preferential allotment to its promoter Co.;*
- *TSL is one of the Group Companies of T Group. S Ltd. proposes to exit from TSL by selling its entire shareholding in T Ltd.*
- *RJL propose to fund a Charitable Foundation owned & controlled by RJL.*

# **Part I**

## **RPTs**

# **Under Companies Act, 2013**

- 1) Transaction by 'Company'
- 2) Transaction is with 'Related Party'
- 3) Transaction is a 'prescribed transaction'

If the answer to all the above question is affirmative, then ask the foll. 2 essential questions for determining approval process:

- A. Whether RPT is in 'ordinary course of business',
- B. Whether RPT is at 'arms' length basis'

# Transaction by ‘company’

8

- Section 2(20) defines ‘company’. It means a company incorporated under this Act or under any previous company law;
- It means: Private Co. or Public Co.



# Key Terms for understanding 'Related Party'

- Director,
- KMP,
- Relative,
- Firm,
- Body Corporate,
- Holding Co.,
- Subsidiary Co.,
- Associate Co.

# Essentials of RPTs: Transaction is with 'Related Party'

Sec. 2(76) defines Related Party:

- i. Director or his relative;
- ii. KMP or his relative;
- iii. Firm, in which director, manager or his relative is partner;
- iv. Pvt. Co. in which director or manager or his relative is a member or director;
- v. Public Co. in which a director or manager is a director *and* holds along with his relatives, more than 2% of its paid-up share capital;

... Essentials of RPTs:  
Transaction is with 'Related Party'

- vi. Any body corporate whose Board of Directors, MD 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 (except advice, directions or instructions given in professional capacity);

... Essentials of RPTs:  
Transaction is with 'Related Party'

- viii. Any **Body Corporate** which is:
- (A) Holding, Subsidiary or an Associate Co. of such co.;
  - (B) Subsidiary of Holding Co. to which it is also subsidiary;
- or
- (C) *Investing Co. or Venturer of a Co.*

- 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;

## Transaction is 'prescribed transaction'

14

- Such related party's appointment to any office or place of profit in the company, its subsidiary company or associate company; and
- Underwriting the subscription of any securities or derivatives thereof, of the company.

## Meaning of 'Office or Place of profit'

15

- **Office is held by Director:** If Director holding it receives from co. anything by way of remuneration over and above remuneration to which he is entitled as director, by way of salary, fee, commission, perquisites, any rent-free accommodation, or otherwise;
- **Office is held by an individual other than a director or by any firm, private co. or other body corporate:** If individual, firm, private co. or body corporate holding it receives from co. anything by way of remuneration, salary, fee, commission, perquisites, any rent-free accommodation, or otherwise.

## Revisiting sample RPTs

16

- *Mrs. AA is Director of T Ltd. Co. proposes to appoint Mrs. AA's daughter as Director,*
- *Mr. AK is promoter & director K Ltd. & A Ltd. Both Cos. propose to enter into a transaction (say – sale of goods)*
- *Mr. B Bajaj is Director in B Insurance Co. Ltd. He proposes to take Health Insurance Policy of B Insurance Co. Ltd.*



## Revisiting the sample RPTs

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- *TM Ltd. proposes to raise capital by making preferential allotment to its promoter Co.;*
- *TSL is one of the Group Companies of T Group. S Ltd. proposes to exit from TSL by selling its entire shareholding in T Ltd.*
- *RJL propose to fund a Charitable Foundation owned & controlled by RJL.*

# Approval Process for RPTs

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18

- Audit Committee Approval – u/s 177(4)
- Board consent at Board Meeting only – u/s 188(1)
- Shareholders Approval – u/s 188(1)

19

# Audit Committee & its approval

# Audit Committee Sec. 177

20

- **Constitution of Audit Committee is mandatory for following Cos.:**
  - 1) Every Listed Co.,
  - 2) All public cos. with a paid up capital of Rs. 10 crore or more;
  - 3) All public cos. having turnover of Rs. 100 crore or more;
  - 4) All public cos., having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding Rs. 50 crore or more.
  
- **Composition of Audit Committee:**
  - 1) Audit Committee shall consist of min. of 3 directors,
  - 2) Independent directors forming a majority:
  - 3) Majority of members of Audit Committee including its Chairperson shall be persons with ability to read and understand, financial statement.

## Audit Committee. Sec. 177

21

- Every Audit Committee shall act in accordance with terms of reference specified in writing by Board of Directors,
- **One of the terms include: Approval or any subsequent modification of transactions of co. with related parties,**
- Audit Committee may make Omnibus Approval for RPTs proposed to be entered into by Co.
- T&Cs for Omnibus Approval have been prescribed in Rules.

# AC's Omnibus Approval

22

- All RPTs shall require AC's approval.
- AC may make omnibus approval for RPTs proposed to be entered into by Co. subject to foll. conditions:
- AC shall, after obtaining Board approval, specify criteria for making omnibus approval which shall include foll.:
  - 1) Max. value of transactions, in aggregate, which can be allowed under the omnibus route in a year,
  - 2) Max value per transaction which can be allowed,
  - 3) Extent and manner of disclosures to be made to AC at the time of seeking omnibus approval,
  - 4) Review , at such intervals as AC may deem fit, RPTs entered into by Co. pursuant to each of the omnibus approval made,
  - 5) Transactions which cannot be subject to omnibus approval by AC.

## ... AC's Omnibus Approval

23

### **Foll. factors should be considered while specifying criteria for making omnibus approval:**

- Repetitiveness of the transactions (in past or in future);
- Justification for the need of omnibus approval.

AC shall satisfy itself on need for omnibus approval for transactions of repetitive nature & such approval is in company's interest.

### **Omnibus Approval shall contain / indicate the foll. :**

- 1) Name of related parties;
- 2) Nature and duration of transaction;
- 3) Max. amount of transaction that can be entered into;
- 4) Indicative base price/current contracted price and formula for variation in the price, if any;
- 5) Any other info. Relevant/important for AC to take a decision on the proposed transaction.

## ... AC's Omnibus Approval

24

- Where need for RPT cannot be foreseen and said details are not available, AC may make omnibus approval for such transactions subject to their value not exceeding **Rs. 1 crore per transaction**.
- Omnibus approval shall be valid for period not exceeding 1 FY & shall require fresh approval thereafter.
- Such approval shall not be made for transactions in respect of selling/disposing of undertaking.



## Cos. (Amendment) Act, 2017

25

- *In case of transaction, other than transactions referred to in section 188, and where Audit Committee does not approve the transaction, it shall make its recommendations to the board of directors;*
  
- *In case any transaction involving any amount not exceeding Rs. 1 crore is entered into by a director or officer of the company without obtaining the approval of the Audit Committee and it is not ratified by the Audit Committee within 3 months from the date of the transaction, such transaction shall be voidable at the option of the Audit Committee and if the transaction is with the related party to any director or is authorised by any other director, the director concerned shall indemnify the company against any loss incurred by it.*

26

# Board of Directors & its consent

## Board's Consent

27

- No co. shall enter into any contract/arrangement with related party w.r.t. certain transactions, except with Board of Directors' consent given by resolution at its meeting;
  
- Where any director is interested in any contract/arrangement with related party, **such director shall not be present at meeting during discussions** on subject matter of resolution relating to such contract/arrangement.

## ... Board's Consent

28

### Board meeting's Agenda shall disclose:

- 1) Name of related party and nature of relationship;
- 2) Nature, duration of contract and particulars of contract/arrangement;
- 3) Material T&C of contract/arrangement including value, if any,
- 4) Any advance paid/received for contract/arrangement, if any;
- 5) Manner of determining pricing and other commercial terms, both included as part of contract and not considered as part of contract;
- 6) Whether all factors relevant to contract have been considered, if not, details of factors not considered with rationale for not considering those factors; and
- 7) Any other info. relevant /important for Board to take a decision on proposed transaction.

# Shareholders Approval

## Shareholders' Approval

30

- Where paid-up share capital / transaction exceeds prescribed limits, Co. shall enter into contract/arrangement after obtaining prior shareholder's approval by Ordinary Resolution.
- Member shall not vote on such resolution, **if such member is a related party.**

# Thresholds for shareholders' approval

Contract / Arrangement with related party with respect to:	Revised Threshold
Sale, purchase or supply of any goods or materials	10% of the turnover or Rs. 100 crore, whichever is lower.
Selling or otherwise disposing of, or buying, property of any kind	10% of net worth of the company or Rs. 100 crore, whichever is lower.
Leasing of property of any kind	10% of the net worth of the company or 10% of turnover of the company or Rs. 100, whichever is lower.
Availing or rendering of any services	10% of the turnover of the company or Rs. 50 crore, whichever is lower.
Appointment of any agent for purchase or sale of goods, materials, services or property	10% of the turnover of the company or Rs. 50 crore, whichever is lower.
Such related party's appointment to any office or place of profit in the company, its subsidiary company or associate company	Monthly remuneration exceeding Rs. 2,50,000/-
Underwriting the subscription of any securities or derivatives thereof, of the company	Remuneration exceeding 1% of the net worth.

## Cos. (Amendment) Act, 2017

32

- *The requirement of passing Special Resolution shall not be applicable for transactions entered into between Holding Co. and its WOS whose accounts are consolidated with such Holding Co. and placed before shareholders for approval;*
- *Special Resolution shall not apply to a Co. in which 90% or more members, in number, are relatives of promoters or are related parties.*



# **Game Changer – 4<sup>th</sup> Proviso to Sec. 188(1) of Cos. Act, 2013**

## Game Changer Provision

34

- *“Nothing in Sec. 188(1) shall apply to any transactions entered into by the company in its ordinary course of business other than transactions which are not on an arm's length basis”*
  
- Provisions of Sec. 188(1) are not applicable, if:
  - 1) Transaction is in ordinary course of business (+)
  - 2) Transaction is on arm's length basis

# Ordinary course of business

35

- Not defined.
- Black's Law Dictionary definition: 'the normal routine in managing a trade or business' and terms it as 'regular course of business', 'ordinary course', 'regular course'
- Broad Factors:
  - 1) Object Clause,
  - 2) Nature of Business & Industry,
  - 3) History of Transactions,
  - 4) Periodicity

## Transaction is on Arm's Length Basis

36

- Explanation (b) to sub-section (1) of Sec. 188: “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;
- Arm’s Length basis **Vs** Arm’s Length pricing,
- Arm’s Length pricing – under Income Tax Act.

## Disclosures in Board's Report

37

- Every contract / arrangement entered into u/s 188(1) shall be referred to in Board's Report to shareholders along with justification for entering into such contract / arrangement [Sec. 188(2)];
  
- Board's Report shall include particulars of contracts / arrangements with related parties referred to in Sec. 188(1) in prescribed form [Sec. 134]

## Form No. AOC – 2 :

38

Form AOC – 2 as prescribed in Cos. (Accounts) Rules, 2014 is divided in 2 parts, namely:

- (1) Details of contracts/ arrangements/ transactions not at arm's length basis,
- (2) Details of *material* contracts/ arrangement/ transactions at arm's length basis.

# Private Cos. – Exemption from Sec. 188 compliance

Foll. parties are not ‘related parties’ to private cos.:

- 1) Holding co.,
- 2) Subsidiary co.,
- 3) Associate co.,
- 4) Subsidiary of holding co. to which it is also subsidiary co.

**Vide: MCA Notification dated June 5, 2015**

## Private Cos. – Exemption from Sec. 188 compliance

40

Member of private co. is eligible to vote on such ordinary resolution, approving contract/arrangement which may be entered into by private co., if such member is a “related party”.

**Related provision:** 2<sup>nd</sup> proviso to Sec. 188(1).

**Vide: MCA Notification dated June 5, 2015**



## Exemption from Sec. 188 compliance

Shareholders' approval where transactions entered into between holding co. and its WOS.

To avail such exemption, it is also mandatory that the accounts of WOS are consolidated with such holding co. and placed before shareholders at general meeting for approval.

**Vide: Companies (Amendment) Act, 2015**

# Exemption from Sec. 188 compliance

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42

MCA exempts cos. from compliance of Sec. 188, arising out of Compromises, Arrangements & Amalgamations.

**MCA Circular dated July 17, 2014**

# **PART 2**

# **Approval Process – Case Studies**

# Approval Process – Case Study 1

44

Pvt. co. proposes to enter into prescribed transaction with prescribed related party.

Transaction is in the ordinary course of business.

Transaction is at arms' length basis.

- ✓ Board consent required?
- ✓ Audit Committee's approval required?
- ✓ Shareholders' approval required?

## Approval Process – Case Study 2

45

Public co. proposes to enter into prescribed transaction with prescribed related party.

Transaction is in the ordinary course of business.

Transaction is at arms' length basis.

(AC formation is not mandatory)

- ✓ Board consent required?
- ✓ Audit Committee's approval required?
- ✓ Shareholders' approval required?

## Approval Process – Case Study 3

46

Public co. proposes to enter into prescribed transaction with prescribed related party.

Transaction is in the ordinary course of business.

Transaction is at arms' length basis.

(AC formation is mandatory)

- ✓ Board consent required?
- ✓ Audit Committee's approval required?
- ✓ Shareholders' approval required?

## Approval Process – Case Study 4

47

Pvt. co. proposes to enter into prescribed transaction with prescribed related party.

Transaction is **not** in the ordinary course of business.

Transaction is at arms' length basis.

- ✓ Board consent required?
- ✓ Audit Committee's approval required?
- ✓ Shareholders' approval required?

## Approval Process – Case Study 5

48

Public co. proposes to enter into prescribed transaction with prescribed related party.

Transaction is **not** in the ordinary course of business.

Transaction is at arms' length basis.

(AC formation is not mandatory)

- ✓ Board consent required?
- ✓ Audit Committee's approval required?
- ✓ Shareholders' approval required?



## Approval Process – Case Study 6

49

Public co. proposes to enter into prescribed transaction with prescribed related party.

Transaction is **not** in the ordinary course of business.

Transaction is at arms' length basis.

(AC formation is mandatory)

- ✓ Board consent required?
- ✓ Audit Committee's approval required?
- ✓ Shareholders' approval required?

# **PART 3**

## **RPTs**

# **Under SEBI Listing Regulations**

# Related Party Transaction

51

- **Clause (zc) of Reg. 2 defines ‘RPT’ as follows:**
- ‘RPT’ means transfer of resources, services or obligations between listed entity & related party,
- Regardless of whether price is charged and,
- ‘Transaction’ with related party shall be construed to include single transaction / group of transactions in a contract,
- Definition shall not be applicable for units issued by mutual funds which are listed on recognised stock exchange(s).

# Related Party

52

Cl. (zb) of Reg. 2 of Listing Regulations defines ‘related party’ as :

- 1) ‘Related Party’ u/s 2(76) of Cos. Act, 2013 or
- 2) ‘Related Party’ under applicable AS.

SEBI’s recent FAQs on Listing Regulations clarified ‘related party’ definition.

# Definition of ‘Relative’

53

Clause (zd) of Reg. 2 defines ‘relatives’ as follows:

- “Relative” means relative as defined in Section 2(77) Cos. Act, 2013 & Co. Rules;
- Definition shall not be applicable for units issued by MF which are listed on recognised SE

- Transaction with related party shall be considered ‘material’ if transaction(s) to be entered into individually or taken together with previous transactions during FY, exceeds 10% of annual consolidated turnover of listed entity as per its last audited financial statements.
- Listed entity shall formulate Policy on materiality of RPTs.

# Approval Process

55

- Audit Committee Approval
- Board Approval
- Shareholders Approval

# Audit Committee's Approval

56

## Defined Role of AC:

- 1) All RPTs shall require prior approval of AC
- 2) Reviewing, with management, annual financial statements and auditor's report, before submission to Board for approval, with particular reference to disclosure of any RPTs;
- 3) Granting approval or any subsequent modification of transactions of listed co. with its related parties;
- 4) Defining 'significant' RPTs
- 5) Reviewing statement of 'significant' RPTs submitted by management



# AC's Omnibus Approval

57

AC may grant omnibus approval for RPTs.

Such approval is subject to foll. conditions:

- Criteria shall be laid down for granting such approval in line with the policy on RPTs,
- Such approval applicable in respect of transactions which are 'repetitive' in nature;
- AC shall satisfy itself regarding need for such approval and such approval is in listed entity's interest.

## ... AC's Omnibus Approval

58

### **Omnibus approval shall specify:**

- Name(s) of related party,
- Nature of transaction,
- Period of transaction,
- Max. amount of transactions that shall be entered into,
- Indicative base price / current contracted price and formula for variation in the price if any;
- Such other conditions as AC may deem fit:

## ... AC's Omnibus Approval

59

- Where need for RPT cannot be foreseen & said details are not available, AC may grant omnibus approval for such transactions subject to their **value not exceeding Rs. 1 crore per transaction**;
- AC shall review, at least on a quarterly basis, details of RPTs pursuant to each of omnibus approvals given;
- Such approvals shall be valid for period not exceeding 1 year,
- AC's omnibus approvals shall require fresh approvals after expiry of 1 year.

# Board Approval

60

- No clear provision in Listing Regulations
- Therefore, reference to Sec. 188 of Cos. Act, 2013

# Shareholders Approval

61

- All *material* RPTs shall require shareholders' approval through resolution;
- Related parties shall abstain from voting on such resolutions whether the entity is related party to particular transaction or not.

## Certain Exemptions

62

AC approval, AC's omnibus approval & shareholders' approval is not required for foll.:

- Transactions entered into between 2 Govt. cos.;
- Transactions entered into between holding co. and its WOS (whose accounts are consolidated and placed before shareholders for approval)

# **PART 4**

## **RPTs:**

# **Cos. Act, 2013 Vs SEBI Listing Reg.**

Sr. No.	Points of Comparison
1	Related Party
2	Specified Transaction
3	Pricing Parameter
4	Ordinary Course of Business
5	Board Approval
6	Audit Committee's Omnibus Approval



# Cos. Act, 2013 Vs SEBI Listing Reg.

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65

Sr. No.	Points of Comparison
7	Trigger point of shareholders' Approval
8	Resolution at shareholders' meeting
9	Voting Restrictions at shareholders' meeting

# Cost Audit perspective of RPTs

## Brief discussion

# **Q&A Session**

**Thank you Institute of Cost Accountants of India  
Western India Regional Council (ICAI - WIRC)  
for the wonderful opportunity!! 😊**

**Thank you Members for active participation! 😊**

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