

LATEST CLARIFICATION BY MCA ON RELATED PARTY TRANSACTION

There are various approvals and disclosures to be made on Related Party transaction by corporates while entering into a transaction with related party. However MCA vide its notification dated July 17, 2014, provided a huge relief to the corporates while entering into any kind of contract or arrangement with related party.

The clarifications issued by MCA are discussed following the provisions of Section on Related Party Transactions.



Section applicable to related party transaction as per the Companies Act, 2013:

Sec 188 read with, The Companies (Meeting of Board and its Powers) Rules, 2014

Sec 188(1):

- 1) Consent of Board of Director by passing a resolution is required for entering in to any contract or arrangement with a related party with respect to following items:
 - 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



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- 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 the company.

Rule 15 - The Companies (Meeting of Board and its Powers) Rules, 2014:

Special Resolution passed by the company is required in case of following conditions:

- I. a company having a paid-up share capital of ten crore rupees or more shall not enter into a contract or arrangement with any related party; or
- II. a company shall not enter into a transaction or transactions, where the transaction or transactions to be entered into—
 - a. As contracts or arrangements with respect to clauses (a) to (e) of sub-section (1) of section 188 with criteria, as mentioned below—
 - i. sale, purchase or supply of any goods or materials directly or through appointment of agents exceeding twenty five percent of the annual turnover as mentioned in clause (a) and clause (e) respectively of sub-section (1) of section 188;
 - ii. selling or otherwise disposing of, or buying, property of any kind directly or through appointment of agents exceeding ten percent of net worth as mentioned in clause (b) and clause (e) respectively of sub-section (1) of section 188;
 - iii. leasing of property of any kind exceeding ten percent of the net worth or exceeding ten percent of turnover as mentioned in clause (c) of sub-section (1) of section 188;
 - iv. availing or rendering of any services directly or through appointment of agents exceeding ten percent of the net worth as mentioned in clause (d) and clause (e) of sub-section (1) of section 188;



Clarification on Related Party Transaction

MCA vide its Notification dated July 17, 2014 has given clarification on following transactions:

1. Second proviso to subsection of section 188 requires that no member of the company shall vote on a special resolution to approve the contract or arrangement (referred to in the first proviso), if such a member is a related party. It is clarified that related party has to be construed with reference only to the contract or arrangement for which the special resolution is being passed. Thus the term related party in the above context refers only to such related party as may be related in the context of the contract or arrangement for which the said special resolution is passed.

For e.g.: Holding & Subsidiary Company

Suppose, the Subsidiary enters in to a contract with a third party (not with its holding company) for which special resolution of shareholders is needed. In this case, although the holding company is a related party to the subsidiary company but still it will be allowed to vote on that special resolution since the contract by the subsidiary company is with a third party and not with its holding company

2. It is clarified that transactions arising out of Compromises, Arrangements and Amalgamations dealt with under specific provisions of the Companies Act, 1956/Companies Act, 2013, will not attract the requirements of section 188 of the Companies Act, 2013.
3. Contracts entered into by companies, after making necessary compliances under Section 297 of the Companies Act, 1956, which already came into effect before the commencement of Section 188 of the Companies Act, 2013, will not require fresh approval under the said section 188 till the expiry of the original term of such contracts. Thus, if any modification in such contract is made on or after 1st April, 2014, the requirements under section 188 will have to be complied with.



Conclusion:

Making it easier for companies, MCA clarified that corporate restructuring activities, including amalgamations, will be excluded from the ambit of related party transactions. The ministry's new rules say that disallowing related party members from voting in special resolution will not apply in cases where the member is not related to the particular contract or arrangement on which the said resolution is being passed. Only 'interested related parties' with regards to a particular transaction would be precluded from voting on the same deal. It is clarified that 'related party' referred to in the second proviso has to be construed with reference only to the contract or arrangement for which the said special resolution is passed. The ministry further clarified that contracts entered under the old law or prior to the commencement of Section 188 of the new law will not require fresh approval until expiry of the original term of such contract. However, the ministry added that if modification in such contract is made on or after April 1, 2014, the requirements under Section 188 will have to be complied with.

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