

Section 188 of Companies Act , 2013 : Related Party Transactions

Section 188 of Companies Act , 2013 (Related Party Transactions) , regulates the transactions (7 types of Contracts / Agreements) entered in by any company with Related Party as defined in the Section 2(76) of Companies Act , 2013.

To Understand the Section 188 , let us recapitulate Section 2(76) first:

Section 2(76) of Companies Act , 2013 : Related Party with reference to a company means -

- (i) A Director or his Relative;
- (ii) A KMP or his Relative;
- (iii) A firm , in which a Director , manager , or relative is a partner;

Example : Mr. X , Director of ABC Ltd. is a partner in ABC & Co. Partnership Firm.

Therefore , in this case Section 188 will be attracted and ABC & Co. Partnership Firm will be a related party of X Ltd. for the purpose of this section.

- (iv) A Private Company in which a Director or Manager or his relative is a Member or Director;

Example : Mr. X , Director of ABC Ltd. is a Director of XYZ Pvt. Ltd. as well. Thus , for the purpose of Section 188 of Companies Act , 2013 , XYZ Pvt. Ltd. shall be a related party of ABC Ltd.

- (v) A Public Company in which a director or manager is a director and holds along with its relatives, more than 2% of its Paid Up Share Capital;

Example : Mr. X , Manager of ABC Ltd. is holding the position of Director in XYZ Ltd. and along with his Wife Mrs. X , holds 4% of Paid up share capital of XYZ Ltd. Thus , Section 188 will be attracted and XYZ Ltd. will be the Related Party of ABC Ltd.

- (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 of the Company;

- (vii) Any person on whose advice , directions or instructions a director or manager is accustomed to act;

Exception : 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;
- (C) An investing company or the venturer of the company

Explanation : For the purposes of this clause , “the investing or the venturer of a company” means a body corporate whose investment in the company would result in the company becoming an associate company of the Body Corporate

- (ix) such other persons as may be prescribed.

Meaning of Relative: As per **Section 2(77) of Companies Act , 2013** , a person shall be deemed to be a relative of another only if :

1. They are Members of a HUF
2. They are husband and wife or
3. The one is related to another in the manner indicated in Rule 4 of Companies (Specification of Definitions Details) Rules , 2014.

As per aforesaid **Rule 4 of Companies (Specification of Definitions Details) Rules , 2014** , a person shall be deemed to be the relative of another in the following manner namely :

1. Father (includes Step - Father)
2. Mother (includes Step - Mother)
3. Son (includes step - son)
4. Son's wife
5. Daughter
6. Daughter's Husband
7. Brother (including Step - Brother)
8. Sister (including step - sister)

As per **Section 188(1) of the Companies Act , 2013** , a company can enter into the following 7 contracts with any Related Party , only after the Prior Approval of the BOD given by a Resolution (BR) at the meeting of the Board (**within 3 months of the Contract**) :

- (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 , it's subsidiary company or associate company; and

Meaning of "Office or Place of Profit":

- (i) Where such office or place is held by a director , if the director holding the it receives from company anything by way of remuneration over and above the remuneration to which he is entitled as a director ;
 - (ii) Where such office or place is held by an individual other than a director or by any firm , private company or other body corporates , if the individual , firm , private company or body corporate holding it receives from the company anything by way of remuneration.
- (g) Underwriting the subscription of any securities or derivatives thereof , of the company.

However , following 6 related party transactions require company's approval by way of Ordinary Resolution if the limits mentioned below exceeds [**Rule 15 of Companies (Meeting of Board and its powers) Rules , 2014**] :

S.NO.	TRANSACTION	LIMITS , IF EXCEEDED OR IS REQUIRED
1.	Sale , Purchase or supply of any goods or materials , directly or indirectly through appointment of agent,	10% or more of the Turnover of the Company
2.	Selling or otherwise disposing of or buying property of any kind , directly or through appointment of an agent,	10% or more of the Net Worth of the Company
3.	Leasing of property of any kind,	10% or more of the Turnover of the Company
4.	Availing or rendering of any services , directly or through appointment of agent,	10% or more of the Turnover of the Company
5.	Appointment to any office or place of profit in the company , its subsidiary company or associate company,	At a monthly remuneration exceeding Rs. 2,50,000
6.	Remuneration for underwriting the subscription of any securities or derivatives thereof , of the company.	Exceeding 1% of the Net Worth.

If it is mandatory for a company to formulate an Audit Committee as per **Section 177** , then it will be necessary to require Audit Committee's Approval. **Rule 6A of Companies (Meeting of Board & its Powers) Second Amendments Rules, 2015** was inserted vide **Notification No. 14.12.2015** states the procedure for obtaining Omnibus Approval of Audit Committee for Related Party Transactions on annual basis.

Note:

1. No Contract or arrangement , in case of a company having a paid up share capital of not less than such sum as may be prescribed , shall be entered into except with prior approval of the company by way of Ordinary Resolution.
2. Approval of BOD / Shareholders is not required for the transactions entered between a holding company and its wholly owned subsidiary whose accounts are consolidated with such holding company and have been placed before shareholders for approval.
3. Approval of BOD / Shareholders is not required for a company in which 90% or more members , in numbers are relatives of promoters or are related parties and no member will vote on such Ordinary Resolution **or** 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.

Exceptions : Above mentioned provision is not applicable to -

- The private company
- Specified IFSC public company.
- GOVERNMENT COMPANY, in respect of the transactions entered with the other government company, whether it is of central government, state government or any combination thereof.

Further , it is clarified via **General Circular No. 30/2014 dated 17th July** that transactions arising out of **Compromises , Arrangements and Amalgamation dealt with under specific provisions of the Companies Act , 2013** will not attract the requirements of Section 188 of Companies Act , 2013.