

Related party transactions – certain clarifications by the MCA

18 July 2014



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The Companies Act, 2013 (the Act), though largely operationalised with effect from 1 April 2014, has thrown up various implementation challenges for corporate India, and one of them relates to provisions concerning 'related party transactions'. The Ministry of Corporate Affairs (MCA), vide general circular no. 30/2014, dated 17 July 2014, has provided clarifications on the matters relating to related party transactions under section 188 of the Act. The clarifications are as follows:

Related party abstention requirement on certain contracts

The second proviso to section 188(1) requires a related party (who is a member) to abstain from voting on a special resolution of a company to approve a contract/arrangement entered into by the company. It was unclear whether such a member would be required to abstain from voting on every contract/arrangement entered into by the company.

The MCA has clarified that a member would be considered as a related party only with reference to a contract/arrangement for which the 'said special resolution' is being passed.

Compromises, arrangements, and amalgamations are outside the ambit of section 188 of the Act

It was unclear whether section 188 also applied to transactions arising out of compromises, arrangements, and amalgamations that are dealt with under the specific provisions of the Companies Act, 1956/the Act.

The MCA has clarified that above transactions will not attract the requirements of section 188 of the Act.

Transactions compliant with section 297 of the Companies Act, 1956, grandfathered

As the Act does not provide any specific transitional provisions in section 188, it was unclear whether existing/continuing contracts (i.e., contracts that have been entered into by a company prior to the section 188 coming into force) would be grandfathered.

The MCA has clarified that those contracts that were entered into by a company before

1 April 2014 (commencement date of section 188 of the Act) in compliance with section 297 of the Companies Act, 1956 will not require fresh approval under section 188 of the Act till the expiry of the original term of such contracts.

If any modification is made in such contracts on or after 1 April 2014, then the requirements under section 188 of the Act would have to be complied with.

Our comments

The MCA has provided some important clarifications on the practical challenges faced by companies while complying with section 188 of the Act. However, grandfathering provisions in particular may not prove to be beneficial to listed companies, especially for material transactions. This is because the amended clause 49 of the Equity Listing Agreement (that is applicable from 1 October 2014) requires all existing material related party contracts/arrangements, which are likely to continue beyond 31 March 2015, to be placed for approval of the shareholders in the first general meeting subsequent to 1 October 2014. Also, certain aspects have not been addressed, such as situations where a transaction is considered to be a related party transaction under section 188 of the Act but was not covered under section 297 of the Companies Act, 1956.

The bottom line

The MCA continues to help facilitate implementation of the Act by issuing such clarifications. However, the areas in which clarifications are required are numerous and we can expect more such clarifications to come through in the coming weeks.



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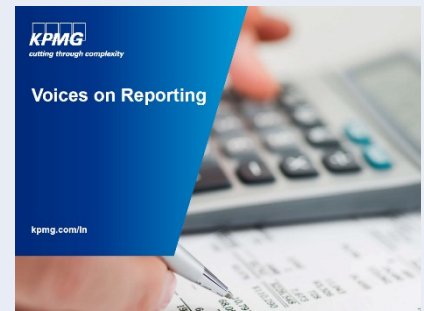
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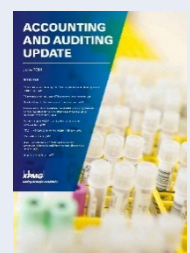
On 28 May 2014, the International Accounting Standards Board and the U.S. Financial Accounting Standards Board issued IFRS 15/ASC 606 Revenue from Contracts with Customers – a new standard that will apply to every entity reporting under IFRS and U.S. GAAP. In our call this month, we discussed the main aspects of IFRS 15.

The Companies Act, 2013 (the Act) was largely operationalised with effect from 1 April 2014. However, there are a number of implementation issues on which various stakeholders have sought clarifications from the Ministry of Corporate Affairs (MCA). Recently, the MCA has issued various clarifications to the Act and amendments to the Rules relating to various chapters of the Companies Act, 2013. In our call, we discussed the MCA clarifications and amendments.

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