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How Related Party Transactions are regulated in India ?



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Introduction

1. Related Party Transaction (RPT) simply means any transaction between two parties who are joined together through a special relationship. Some of the examples are:

- ◆ A director or his relative;
- ◆ A key managerial personnel 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;
- ◆ Anybody 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;
- ◆ Any person on whose advice, directions or instructions a director or manager is accustomed to act:

Corporates generally transact amongst group entities or related parties for operational ease. However, it can easily be misused by the corporates as a tool to evade taxes. This is also evident from some of the recent corporate scams.

Government has been finding various means and ways to regulate these types of transactions. Thus, various legislations operational in India have made it mandatory to report the transactions with the concerned authority. The reporting regime prevalent in India aims to assess the genuineness of the transaction by comparing it with Arm's length transaction.

2. Two regulations which deal with RPTs in India

- ◆ The Income Tax Act, 1961; and
- ◆ The Companies Act, 2013.

These have been discussed in details below:-

2.1 Income Tax Act, 1961

<i>Type of Reporting</i>	<i>Transactions to be reported</i>	<i>Purpose of reporting</i>	<i>Consequence</i>	<i>Due Date</i>
Tax Audit Report	Any expense (capital or revenue) in respect of which payment has been made to a person referred to as "Related Party"	<ul style="list-style-type: none"> ♦ Auditor to certify that the expense is not reasonable and excessive. If otherwise, same needs to be mentioned in a note. ♦ This helps Indian Revenue Authority in examining the genuineness of the transaction. 	So much of the expenses which are excessive and unreasonable will not be allowed as business expenditure and, hence, would be added to the taxable income of the taxpayer	<ul style="list-style-type: none"> ♦ September 30, 2017 ♦ November 30, 2017 (for corporates having international transaction)
Form 3CEB (Due Date- November 30)	<ul style="list-style-type: none"> ♦ International transaction (a) transaction between two or more associated enterprises, either or both of whom are non-residents. ♦ Specified Domestic transaction (exclusive list prescribed) if the aggregate value of all the specified domestic transactions exceeds the threshold limit of INR 5 Crore 	<ul style="list-style-type: none"> ♦ To ensure that the transaction with the related party is at arm's length ♦ Any deviation needs to be reported 	Taxable income of the taxpayer is adjusted if the value of transaction is not at arm's length price	<ul style="list-style-type: none"> ♦ November 30, 2017

The Companies Act, 2013

2.2 The corporates entering into specified transactions with the related party have to seek following approvals:

- (1) Approval of board of directors. director who has `a specified interest` in the contract or arrangement with such related party must not be present at the meeting during the discussions pertaining to the subject matter of the contract or arrangement. However, private companies are exempted from this obligation, upon disclosure of interest by directors.
- (2) Shareholders' approval is required in case the amount of transaction exceeds prescribed threshold limit. However, private companies are exempted from this obligation, upon disclosure of interest by directors.

However, the above-stated conditions shall not be applicable in case of transactions which a company enters, into in its ordinary course of business which are on arm`s length basis.

Non-Compliance

3. In cases where a contract or an arrangement is entered into by a director or any other employee, without obtaining the consent of the board or approval in the general meeting then in such cases, the contract or arrangement shall be treated as voidable at the option of board of directors. In case of listed company, such a director or employee who contravene the provisions of the act shall be punishable with imprisonment for a term which may extend to one year or fine of not less than twenty-five thousand rupees which may extend to five lakh rupees or both and in case of any other company, such director or employee shall be punishable with fine of not less than twenty-five thousand rupees, but which may extend to five lakhs.

Disclosures

4. There is no specific reporting requirement before any authority. However, the company needs to do certain disclosures as stated below:-

<i>Disclosures</i>	<i>Type</i>	<i>Consequence</i>
Board Meeting	<p>The agenda of the board meeting in which resolution is passed must consist of following:</p> <ul style="list-style-type: none"> ◆ Name and nature of relationship with related party ◆ The duration of the contract ◆ Material terms of the contract or arrangement ◆ If any advance has been paid or received for the contract or arrangement ◆ Manner of determining pricing and commercial terms 	<ul style="list-style-type: none"> ◆ In case of listed company, such a director or employee who contravenes the provisions of the Act shall be punishable with imprisonment for a term which may extend to one year or fine of not less than twenty-five thousand rupees which may extend to five lakh rupees or both ◆ In case of any other company, such director or employee shall be punishable with fine of not less than twenty-five thousand rupees but which may extend to five lakhs.
Disclosures by interested directors	<ul style="list-style-type: none"> ◆ Every director having any direct or indirect interest in 	<ul style="list-style-type: none"> ◆ If a director contravenes this provisions such director shall be

the contract or arrangement must disclose that interest and concern. Such director is also not allowed to participate in such meeting, except in case of private companies.

punishable with imprisonment for a term which may extend to one year or with fine which shall not be of less than fifty thousand rupees but which may extend to one lakh rupees, or with both.

Shareholders' Meeting

- ◆ In case, the amount of transaction exceeds the limits prescribed, the approval of shareholders will also be required.

Explanatory Statement annexed with the Notice calling for General meeting, will also include the prescribed details of the transactions proposed, such as basis of transactions, material terms, amount, and relationship with the related party, etc.

- ◆ In case of listed company, such a director or employee who contravenes the provisions of the Act shall be punishable with imprisonment for a term which may extend to one year or with fine of not less than twenty-five thousand rupees which may extend to five lakh rupees or both
- ◆ In case of any other company, such director or employee shall be punishable with fine of not less than twenty-five thousand rupees but which may extend to five lakhs.

Director's report

- ◆ Every related party transaction shall be disclosed in the board's report along with justification of entering into such transaction

- ◆ Punishable with a fine which shall not be of less than fifty thousand rupees but which may extend to twenty-five lakh rupees; and
- ◆ every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be of less than fifty thousand rupees but which may extend to five lakh rupees, or with both.

Register

- ◆ Every related party transactions must be disclosed in the register maintained by the company

- ◆ Every director who fails to comply with the provisions of this section and the rules made thereunder shall be liable to a penalty of twenty-five thousand rupees.

Annual Filing

- ◆ Submission of company's Annual report which includes audited financial statement and Director's report with the Registrar of Companies within 30 days from the date of Annual general Meeting

- ◆ The company shall be punishable with fine of one thousand rupees for every day during which the failure continues but which shall not be more than ten lakh rupees;
- ◆ Following person shall be punishable with imprisonment for a term which may extend to six months or with fine

which shall not be of less than one lakh rupees but which may extend to five lakh rupees, or with both:

- (1) the Managing Director and the Chief Financial Officer of the company
- (2) In the absence of above two, any other director who is charged by the Board with the responsibility of complying with the provisions of this section, and
- (3) in the absence of the above, all the directors of the company.

Concluding Remarks

5. Though it is very critical to have RPT from commercial standpoint, yet it is important to have the same regulated. But having said this, it cannot be denied that a related-party transaction can play a beneficial role by saving transaction costs and improving the operating efficiency of a company. In fact, there may be several transactions that are unavoidable because they make commercial sense for the company; if companies are prohibited from entering into such transactions, it might work against the principle of maximising the shareholders value.

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