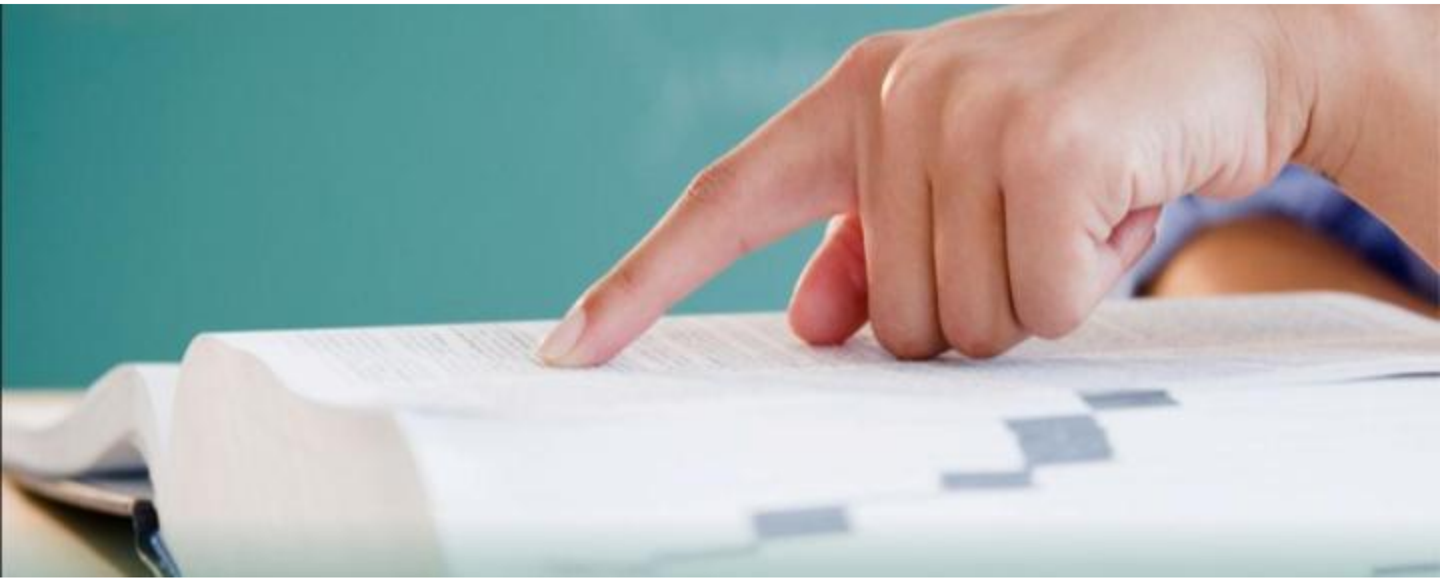
cutting through complexity

FIRST NOTES
KPMG in India

The MCA amends shareholder approval norms for related party transactions

19 August 2014



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Immediately

Within the next 3 months

Post 3 months but within 6 months

Post 6 months

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 notification dated 14 August 2014, has amended the Companies (Meetings of Board and its Powers) Rules, 2014 (Rules).

The amended Rules will be effective from the date of its publication in the Official Gazette. This issue of First Notes provides an overview of the changes regarding the shareholders' approval requirements under the Rules.

Shareholders' approval for related party transactions

First proviso to section 188 of the Act requires prior approval of shareholders by special resolution for related party transactions prescribed under section 188(1) that are neither in the ordinary course of business of the company nor on an arm's length basis. Under the Rules shareholders' approval would be required when:

- the paid-up share capital of the company is INR100 million or more
- prescribed transaction level thresholds have been exceeded.

This meant that all medium to large companies having paid-up share capital in excess of INR100 million had to place related party transactions meeting this criteria before the shareholders, irrespective of the transaction value involved. This posed a significant impediment given that a prior approval was required even for immaterial transactions through a special resolution with the interested related party abstaining from voting.

The amended Rules have removed the paid-up share capital criterion and have revised transaction level thresholds i.e. included an absolute monetary limit for certain transactions, beyond which the related party transactions would require shareholders' approval.

A comparison between the existing requirements and the amended Rule 15 sub-rule (3) with regard to shareholders' approval in relation to related party transactions which are neither in the 'ordinary course of business' nor on an 'arm's length basis' is as follows:

Prescribed transaction categories	Existing requirements	Amended Rules
Sale purchase or supply of any goods or material (directly or through an agent)	Exceeding 25 per cent of annual turnover	Exceeding 10 per cent of turnover or INR1 billion, whichever is lower*
Selling or otherwise disposing of, or buying property of any kind (directly or through an agent)	Exceeding 10 per cent of net worth	Exceeding 10 per cent of net worth or INR1 billion, whichever is lower*
Leasing of property of any kind	Exceeding 10 per cent of net worth or 10 per cent of turnover	Exceeding 10 per cent of net worth or 10 per cent of turnover or INR1 billion, whichever is lower*
Availing or rendering of any service (directly or through an agent)	Exceeding10 per cent of net worth	Exceeding 10 per cent of turnover or INR500 million, whichever is lower*
Appointment to any office or place of profit in the company, subsidiary company or associate company	Remuneration exceeding INR0.25 million per month	No change
Underwriting the subscription of any securities or derivatives of the company	Remuneration exceeding one per cent of net worth	No change

*Applies to transaction or transactions to be entered into either individually or taken together with the previous transactions during a financial year.

Other key amendment to the Rules

Rule 4(iv) prescribes matters that can not be dealt with through video conferencing or other audio visual means. The amended Rule now provides that audit committee meetings can not consider financial statements including consolidated financial statements, if any, to be approved by the Board under section134(1) of the Act through the video conferencing or other audio visual means.

Our comments

- The amendments made by the MCA in the context of approval of related party transactions are significant. While the amendments do not remove all the practical challenges that corporates are facing, it is still a step in the right direction. The MCA has provided timely clarification on the practical challenges faced by companies while complying with section 188 of the Act.

- The shareholder approval requirements will now apply only to transactions meeting certain transaction thresholds, rather than to all transactions that are not in the ordinary course of business and on an arm's length basis as per the earlier notified rules, which posed a challenge to many corporates. However, the introduction of absolute monetary thresholds still would require several transactions that are not considered to be material for a large company, to be referred to shareholders for approval.

- Additionally, though not abundantly clear but it appears that the individual related party transactions pertaining to different categories (see the table above) should not be aggregated for consideration of the limits as per the amended Rules for the shareholders' approval.

- Despite these amendments, the differences with the revised clause 49 of the Equity Listing Agreement issued by the Securities and Exchange Board of India (SEBI) continue to exist. The SEBI requirements are purely materiality based and do not consider 'arm's length' or 'ordinary course of business' conditions.

The bottom line

The amendments are a clear reflection of the fact that MCA continues to consider the practical challenges faced by corporates in the implementation of the Act, and has responded with amendments to make the law more pragmatic and yet achieve its objective.

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Introducing Voices on Reporting

KPMG in India is pleased to present Voices on Reporting – a monthly series of knowledge sharing calls to discuss current and emerging issues relating to financial reporting.

On 10 July 2014, the Finance Minister of India announced a roadmap and definite dates for convergence with the International Financial Reporting Standards (IFRS) for Indian companies as part of his Union Budget speech. The Finance Minister proposed to make Indian Accounting Standards (Ind AS) converged with IFRS mandatory for Indian companies from the financial year 2016-17. He also stated that 'income computation and disclosure standards' (tax accounting standards) would be notified separately. TAS are expected to take effect from 1 April 2015 and in relation to the assessment year 2015-16 and subsequent years.

This is a significant development and will most likely apply to several companies. We discussed the implementation challenges put forth by the convergence with IFRS and use of tax accounting standards for the corporate India.

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