


# Related Party Transactions and Disclosure of Director’s Interest: Sections 184, 188 and 189 of the Companies Act, 2013

## Description

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**Quick summary**

- A related party includes a director or KMP and their relatives, a firm or private company in which a director or manager or relative is a partner, member or director, and a holding, subsidiary or associate company, among others (section 2(76)).
- A company can enter into the listed types of contracts with a related party (sale or purchase of goods, property, leases, services, agents, office or place of profit, underwriting) only with the consent of the Board at a meeting. Above the prescribed limits, members must approve by resolution, and related party members cannot vote.
- Transactions in the ordinary course of business and at arm’s length are outside section 188(1). The Board’s report must refer to each contract with the justification.
- An unapproved contract that is not ratified within three months is voidable. Penalty on the director or employee: Rs 25 lakh in a listed company and Rs 5 lakh in any other company.

When a company deals with people who control it or are close to those who control it, the price and terms may not be what an outsider would get. The Companies Act, 2013 handles this with three safeguards: a wide definition of “related party” (section 2(76)), an approval process for transactions with them (section 188), and a duty on every director to disclose personal interests (section 184), with a register of contracts (section 189).

## Who is a related party (section 2(76))

1. A **director or his relative**;
2. a **key managerial personnel or his relative**;
3. a **firm** in which a director, manager or his relative is a partner;
4. a **private company** in which a director, manager or his relative is a member or director;
5. a **public company** in which a director or manager is a director and holds, along with his relatives, **more than 2%** of the paid-up share capital;
6. a **body corporate** whose Board, managing director or manager is accustomed to act on the advice, directions or instructions of a director or manager;

7. a **person on whose advice, directions or instructions** a director or manager is accustomed to act (clauses 6 and 7 do not apply to advice given in a professional capacity);
8. a body corporate that is a **holding, subsidiary or associate company**, a **subsidiary of the holding company** to which it is also a subsidiary, or an **investing company or venturer** of the company; and
9. such other person as may be prescribed.

A **relative** means a member of the same Hindu Undivided Family, husband and wife, or a person related in the prescribed manner (section 2(77)).

## Transactions covered by section 188(1)

A contract or arrangement with a related party relating to:

- sale, purchase or supply of any goods or materials;
- selling or otherwise disposing of, or buying, property of any kind;
- leasing of property of any kind;
- availing or rendering of any services;
- appointment of any agent for purchase or sale of goods, materials, services or property;
- the related party's appointment to any **office or place of profit** in the company, its subsidiary or associate company; and
- underwriting the subscription of any securities or derivatives of the company.

## What approval is needed

- **Board consent:** no such contract may be entered into **except with the consent of the Board** given by a resolution at a meeting, subject to prescribed conditions.
- **Shareholders:** where the company's paid-up share capital is at or above the prescribed amount, or the transactions exceed the prescribed sums, the contract needs the **prior approval of the company by resolution**. **No member who is a related party can vote** on that resolution (this does not apply to a company in which 90% or more of the members, in number, are relatives of promoters or related parties).
- **Exceptions:** section 188(1) does not apply to transactions in the **ordinary course of business** that are on an **arm's length basis**, nor does the shareholders' resolution requirement apply to transactions between a holding company and its **wholly owned subsidiary** whose accounts are consolidated with the holding company and placed before the shareholders at the general meeting.
- **Arm's length transaction** means a transaction between two related parties that is conducted as if they were unrelated, so that there is no conflict of interest.
- **Office or place of profit:** for a director, anything received above the remuneration due to him as a director; for anyone else, any remuneration, salary, fee, commission, perquisites or rent-free accommodation received from the company.

## Reporting and consequences

- **Board's report:** every contract or arrangement under section 188(1) is referred to in the Board's report to the shareholders, with the **justification** for entering into it (section 188(2)).
- **Voidable contracts:** if a director or employee enters into a contract without Board consent or shareholders' approval and it is **not ratified within three months**, it is **voidable** at the option of the Board or the shareholders. If it is with a related party of a director, or authorised by another director, the directors concerned must **indemnify the company** against any loss (section 188(3)).
- **Recovery:** the company can proceed against the director or employee to recover any loss (section 188(4)).

- **Penalty (section 188(5)):** a director or employee who entered into or authorised the contract in violation is liable to a penalty of **Rs 25 lakh** in a listed company and **Rs 5 lakh** in any other company.

## Section 184: disclosure of interest by a director

- **General disclosure (section 184(1)):** every director discloses his concern or interest in any company, body corporate, firm or association of individuals, including shareholding, at the **first Board meeting in which he participates**, at the **first Board meeting of each financial year**, and at the first meeting after any **change** in what he has disclosed.
- **Specific disclosure (section 184(2)):** a director who is concerned or interested in a contract or arrangement with a body corporate in which he (with others) holds **more than 2%**, or is a promoter, manager or CEO, or with a firm or entity in which he is a partner, owner or member, discloses the nature of his interest at the Board meeting where it is discussed and **does not participate**. If he becomes interested after the contract is made, he discloses forthwith or at the first Board meeting after.
- **Consequences (section 184(3) and (4)):** a contract made without disclosure, or with participation by an interested director, is **voidable at the company's option**, and the director is liable to a **penalty of Rs 1 lakh**.
- **Small shareholdings (section 184(5)(b)):** the section does not apply to contracts between companies where a director holds not more than 2% in the other company.

## Register of contracts: section 189

- Every company keeps one or more **registers** of all contracts or arrangements to which section 184(2) or section 188 applies, in the prescribed manner, placed before the **next Board meeting** and signed by all directors present.
- A director or KMP discloses within **30 days** of appointment or relinquishment the particulars of his concern or interest in other associations.
- The register is kept at the registered office, open to inspection during business hours, and produced at the **start of every AGM**.

## A short compliance checklist

1. Keep a live list of related parties, updated at each Board meeting from the directors' disclosures.
2. Test each proposed transaction: is it with a related party, is it one of the seven types, is it in the ordinary course and at arm's length?
3. If not exempt, get Board consent at a meeting, and check the prescribed monetary thresholds for the shareholders' resolution.
4. The interested director leaves the discussion; related party members do not vote on the shareholders' resolution.
5. Record the justification, put it in the Board's report, and enter the contract in the register.

## Points to check

- This post follows the Companies Act as published on India Code, including its amendments up to the footnotes in that edition. The monetary thresholds for the shareholders' resolution, the conditions for Board consent, the register form and the extra list of related parties are in the Rules, which were not reviewed.
- Listed companies have further requirements under the SEBI listing regulations, including audit committee approval of related party transactions.

- The statutory auditor reports on related party compliance under clause (xiii) of the Companies (Auditor's Report) Order, 2020.

## Frequently asked questions

### Who is a related party?

Under section 2(76): a director or his relative; a KMP or his relative; a firm in which a director, manager or relative is a partner; a private company in which a director, manager or relative is a member or director; a public company in which a director or manager, with relatives, holds more than 2% of paid-up capital; a body corporate whose Board or manager acts on a director's advice; a person on whose advice a director acts (other than in a professional capacity); a holding, subsidiary or associate company, a fellow subsidiary, and an investing company or venturer; and any person prescribed.

### Which transactions does section 188 cover?

Contracts or arrangements with a related party for: sale, purchase or supply of goods or materials; selling, disposing of or buying property; leasing property; availing or rendering services; appointing an agent for purchase or sale; the related party's appointment to an office or place of profit in the company, its subsidiary or associate; and underwriting the subscription of the company's securities.

### Is Board approval enough?

The Board's consent at a meeting is required for every such contract. Where the paid-up capital or the value of the transaction exceeds the prescribed amounts, the company's prior approval by resolution is also needed, and no member who is a related party can vote on it.

### When is section 188(1) not applicable?

To transactions in the ordinary course of business that are on an arm's length basis, and to transactions between a holding company and its wholly owned subsidiary whose accounts are consolidated with it and placed before shareholders at the general meeting (the requirement of a shareholders' resolution is not applicable to them).

### What happens if the contract is entered into without approval?

If it is not ratified by the Board or the shareholders within three months from the date it was entered into, it is voidable at the option of the Board or the shareholders, and the concerned directors must indemnify the company against any loss where the contract is with a related party to a director or was authorised by another director.

### What is the penalty?

A director or employee who entered into or authorised the contract in violation is liable to a penalty of Rs 25 lakh in a listed company and Rs 5 lakh in any other company.

### What must a director disclose?

At the first Board meeting in which he participates, and at the first meeting of each financial year (and after any change), his concern or interest in other companies, bodies corporate, firms and associations. A director interested in a contract must disclose the nature of the interest at the Board meeting and not participate. A contract entered into without such disclosure or with such participation is voidable at the company's option, and the director is liable to Rs 1 lakh.

## Official sources

- India Code: The Companies Act, 2013 (sections 2(76), 2(77), 184, 188, 189)
- Ministry of Corporate Affairs

## Related reading

- Related Party Transactions and Disclosure of Director's Interest: Sections 184, 188 and 189 of the Companies Act, 2013
- Key Managerial Personnel (KMP) under Section 203 of the Companies Act, 2013: Who They Are, Appointment, Vacancy and Penalty
- CARO 2020: Applicability, Exemptions and the 21 Clauses of the Companies (Auditor's Report) Order

## Disclaimer

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