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Introduction

Welcome to the Indian Journal of Legal Affairs and Research (IJLAR), a distinguished platform dedicated to the dissemination of comprehensive legal scholarship and academic research. Our mission is to foster an environment where legal professionals, academics, and students can collaborate and contribute to the evolving discourse in the field of law. We strive to publish high-quality, peer-reviewed articles that provide insightful analysis, innovative perspectives, and practical solutions to contemporary legal challenges. The IJAR is committed to advancing legal knowledge and practice by bridging the gap between theory and practice.

Preface

The Indian Journal of Legal Affairs and Research is a testament to our unwavering commitment to excellence in legal scholarship. This volume presents a curated selection of articles that reflect the diverse and dynamic nature of legal studies today. Our contributors, ranging from esteemed legal scholars to emerging academics, bring forward a rich tapestry of insights that address critical legal issues and offer novel contributions to the field. We are grateful to our editorial board, reviewers, and authors for their dedication and hard work, which have made this publication possible. It is our hope that this journal will serve as a valuable resource for researchers, practitioners, and policymakers, and will inspire further inquiry and debate within the legal community.

Description

The Indian Journal of Legal Affairs and Research is an academic journal that publishes peer-reviewed articles on a wide range of legal topics. Each issue is designed to provide a platform for legal scholars, practitioners, and students to share their research findings, theoretical explorations, and practical insights. Our journal covers various branches of law, including but not limited to constitutional law, international law, criminal law, commercial law, human rights, and environmental law. We are dedicated to ensuring that the articles published in our journal adhere to the highest standards of academic rigor and contribute meaningfully to the understanding and development of legal theories and practices.

REGULATION OF RELATED PARTY TRANSACTIONS IN INDIA: A CRITICAL ANALYSIS OF LEGAL FRAMEWORK AND GOVERNANCE CHALLENGES

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ABSTRACT

In nations like India, where business ownership is mostly concentrated in family-controlled entities, related party transactions represent a crucial but complicated component of corporate governance. Although RPTs facilitate effective resource allocation and lower transaction costs within corporate settings, they also present serious abuse risks, such as value diversion from minority shareholders to controlling promoters.

This paper explores the legal and regulatory landscape surrounding Related Party Transactions, offering a comparative analysis of global practices. It also examines India's regulatory framework as outlined in the Companies Act of 2013, the SEBI (Listing Obligations and Disclosure Requirements) Regulations of 2015.

Recent regulatory developments, including the introduction of Industry Standards by SEBI and the revised materiality thresholds under the 2025 amendments, have been critically evaluated for their effectiveness in enhancing transparency, accountability, and shareholder protection. However, several practical challenges remain, including the identification of related parties, fluctuating shareholdings, and the expansive definitions of promoter groups.

This paper proposes a forward looking approach that emphasizes aligning pricing with economic contribution, adopting technological tools for monitoring and compliance, and ensuring continuous policy refinement by listed entities. Ultimately, effective governance of RPTs requires

a balanced framework that preserves their economic utility while safeguarding stakeholder interests through strong regulatory oversight and corporate accountability.

Key Words: Related Party Transactions, Arm's length, Ordinary Course Of Business, Materiality Threshold, Industry Standard Forum.

INTRODUCTION

Corporate governance frameworks are designed to mitigate risks, uphold the interests of all stakeholders and it attempts to control conflicts among corporate constituencies. However, every framework has sensitive pressure points. One of the most significant pressure points is 'Related Party Transaction' which can serve as a direct channel for the value diversion i.e. taking economic value away from shareholders or intended beneficiaries. A related-party transaction ("hereinafter RPT") refers to a transaction between two parties who are joined by a special relationship prior to the transaction; the transaction could be a business deal, a single or a series of financial contracts, or an arrangement.¹

In recent years, numerous experts have identified the misuse of related-party transactions as a major worry for corporate governance reformers in Asian nations, especially in India.² Moreover, in India, approximately 85% of all enterprises are family-controlled businesses, which contribute to more than 50% of total employment.³ This ownership structure may lead to conflicts of interest between promoters and minority investors. If the enterprise produces a profit, the promoter group must divide it with minority investors but to increase their profit share, promoters can shift resources to himself or another firm in the promoter group with a bigger portion of ownership.⁴

As a threshold issue, one might wonder why transactions between related parties are even allowed, considering their potential for exploitation by corporate insiders. RPTs are regarded as efficient

¹Srinivasan, Padmini. "An analysis of related-party transactions in India." *IIM Bangalore Research Paper* 402 (2013).

²OECD, *Guide on Fighting Abusive Related Party Transactions in Asia*, September 2009

³E.K. Satheesh, K.P. Muraleedharan A.C Fernando, 'Corporate Governance, Principles, Policies and Practices', pg.516 (3rd ed. 2017)

⁴Bebchuk, Lucian A., and Assaf Hamdani. "The elusive quest for global governance standards." *U. pa. L. rev.* 157 (2008): 1263.

business transactions because they facilitate resource allocation among affiliates at lower transaction costs and create internal markets for products and services within a corporate group.⁵

LEGAL STRATEGIES FOR RELATED PARTY TRANSACTIONS: **GLOBAL PERSPECTIVE**

Corporate laws in almost all jurisdictions resort to an array of legal tactics to bind related party transactions.⁶ Corporate regulators around the world acknowledge that, if unregulated, RPTs might be abused. As a result, disclosure and approval procedures are governed by strong legislation in the majority of jurisdictions.

United States: Strict regulations pertaining to related-party transactions apply to public enterprises. Detailed disclosures of related-party transactions in financial statements and annual reports are required by a number of regulatory agencies, including the Securities and Exchange Commission (SEC) in the United States. These rules are intended to give investors a clear picture of the type and scope of these transactions so they can make wise choices. Serious fines, legal ramifications, and reputational harm to the business can arise from breaking these rules.⁷

United Kingdom: Rule 11 of the Listing Rules provide for shareholders' approval where RPT value \geq 5% of company's gross assets, profits, market value of shares; gross capital before entering into transaction or before completion of transaction and in case of material change (increase of 10% or more in consideration).⁸

⁵Kraakman, Reinier H., and John Armour. *The anatomy of corporate law: A comparative and functional approach*. Oxford university press, 2017.

⁶ Enriques, Luca. "Related party transactions: Policy options and real-world challenges (with a critique of the European Commission proposal)." *European Business Organization Law Review* 16.1 (2015): 1-37.

⁷ M. Blankenship, J. Botros., *Related-Party Transactions Guide – 2025* https://www.winston.com/a/web/5ZXTuUYKHnT6WxK4uPpCB/pubco_related-party-transactions-guide-2024_oct2024.pdf

⁸ A. B. Ansari, Vinod Kothari & Company RPT provisions in India and other countries. <https://vinodkothari.com/wp-content/uploads/2021/09/RPT-provisions-in-India-and-other-countries.pdf>

LIFE CYCLE OF RELATED PARTY TRANSACTIONS

1. Accurate identification of related parties and related party transactions.
2. Updated disclosure norms governing them.
3. Maintaining robust documentation.
4. Arm's length pricing validation.
5. Timely disclosure before stock exchange and stakeholders.
6. Continuous monitoring and periodic review.

INDIAN LAW ON RELATED PARTY TRANSACTIONS

In India, related party transactions are regulated through three fundamental sources:

1. Companies Act, 2013 and Rules made thereunder (Rule 15 of Companies (Meeting of Board and its Powers) Rules, 2014);
2. SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015
3. Accounting Standard (AS) 18, Indian Accounting Standard (Ind AS) 24

WHO ARE RELATED PARTY:

The initial challenge in any RPT study is ascertaining if the parties in question fall under legal net. The term 'related party' has been defined in section 2(76) of the 2013 Act which includes directors, key managerial personnel or their relatives; any company which is a subsidiary of the holding company to which it is also a subsidiary or other entities or persons associated etc.⁹ Regulation 2(1)(zb) of SEBI (LODR) Regulations, 2015 defines 'related party' as entities or persons defined under section 2(76) of the Companies Act, 2013 and further states that a related party includes any person or entity that is part of the promoter or promoter group of the listed entity including definitions as per the Accounting Standard AS 18 and Ind AS 24.¹⁰

The SEBI (LODR) Regulations' definition of "related party" is more comprehensive than any other law since it includes the categories of related parties under the Companies Act and the

⁹ The Companies Act, 2013 (Act No. 18 of 2013) s. 2(76).

¹⁰ Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, reg. 2(1)(zb), No.SEBI/LAD-NRO/GN/2015-16/013

relevant Accounting Standards. SEBI constituted a Working Group¹¹ in November 2019 to review the policy space pertaining to related party transactions and was of that view that all persons or entities belonging to the ‘promoter’ or ‘promoter group’, irrespective of their shareholding in the listed entity, should be deemed to be related parties since a sizable portion of Indian businesses are set up as intrinsically linked group entities that function as a single economic unit, with the promoters exercising influence over the entire group.¹² The definition of related party is not fully harmonised across these frameworks which creates interpretational complexities.

RELATED PARTY TRANSACTIONS:

Section 188¹³ of the Companies Act, 2013 constitutes the central statutory mechanism for governing related party transactions. S. 188 of the 2013 Act is akin to ss. 294, 294A, 294AA, 297 and 314 of the 1956 Act.¹⁴ It unlike the 1956 Act introduces self regulation and leaves the decision to the Board of Directors and shareholders of the company on related party transactions.¹⁵

Section 188(1) of the 2013 Act specifies seven categories of transactions with related parties which require prior approval of the Board granted at a meeting of the Board of Directors of the company. As per the second proviso to s. 188(1) of the 2013 Act, a member who is a related party with respect to the concerned transaction shall not be entitled to vote on the said resolution. Listed companies are subject to Regulation 23 of the SEBI (LODR) Regulations, 2015. It requires shareholder approval for major transactions, the Audit Committee’s previous permission, and the notification of material RPTs to stock exchanges. When necessary, audit committees must grant omnibus approval; disclosures must be documented in the minutes, and regular reviews must be guaranteed.

¹¹ Report of the Working Group on Related Party Transactions https://dur682txgv28e.cloudfront.net/pointers/c9c168c0-d5a6-4eef-9ace-2f8c4a8b0a18/pdf_doc/8fbd2ad4-7457-4847-9277-105a81468cce_DCR10093.pdf

¹² Guidance Note on Related Party Transactions by The Institute of company secretaries of INDIA https://www.icsi.edu/media/webmodules/GN5_Guidance_Note_on_Related_Party_Transactions.pdf

¹³ The Companies Act, 2013 (Act No. 18 of 2013) s. 188.

¹⁴ The Companies Act, 1956 (Act No. 1 of 1956).

¹⁵ A. Ramaiya, Guide to the Companies Act. (ed. 18th)

According to the Companies Act, 2013 and SEBI's (LODR) regulations, Related Party transactions must take place on an "arm's length" basis, requiring board and shareholder permission unless they are part of the "ordinary course of business".

ORDINARY COURSE OF BUSINESS:

Ordinary course of business is not defined but in common parlance, 'ordinary course of business' would include transactions which are entered in the normal course of the business pursuant to or for promoting or in furtherance of the company's business objectives, as per the charter documents of the company.

To decide whether an activity which is carried on by the business is in the 'ordinary course of business', the following factors may be considered:

- a. Whether the activity is covered in the objects clause of the Memorandum of Association. (*Matrix Logistics Ltd. v. CIT*¹⁶).
- b. Whether the activity is in furtherance of the business.
- c. Whether there is a reasonable connection between the activity and the nature of the business carried on by the company. (*A. Ebrahim and Company v. State of Bombay*¹⁷).
- d. Whether the activity is normal or otherwise routine for the particular business (i.e. activities like advertising, staff training, etc.).
- e. Whether the activity is repetitive/frequent. (*Herbertsons Ltd. v. Deputy CIT*¹⁸).
- f. Whether the income, if any, earned from such activity/transaction is treated as business income in the company's books of account.
- g. Whether the transactions are common in the particular industry.
- h. Whether there is any historical practice to conduct such activities.
- i. The financial scale of the activity with regard to the operations of the business.
- j. Revenue generated by the activity.
- k. Sale of old machinery undertaken not with profit motive is not in the ordinary course of business. (*Commissioner of Sales Tax v. Hindustan Spinning and Weaving Company Ltd*¹⁹).

¹⁶ 122 ITD 228

¹⁷ 13 STC 877

¹⁸ 87TTJ 840

¹⁹ 15 STC 69

I. Resources committed to the activity.

The above list is not exhaustive. To ascertain whether a transaction is in the regular course of business, none of the aforementioned factors should be considered separately.

In the case of *Seksaria Biswan Sugar Factory v. Commissioner of Income Tax*²⁰, the Hon'ble High Court decided that the amount lent by the company to a third party will not be in the ordinary course of business. The Court observed that just because an activity is included in the Memorandum of Association, the activity per se does not become an activity in the ordinary course of business of the company. It must be found as to whether the particular act has any connection with the normal business that the company is carrying on and whether it is so related to the business of the company that it can be considered to be performed in the ordinary course of the business of that company.

ARM'S LENGTH BASIS

The term has been defined under explanation (b) to section 188(1) as “a transaction between two related parties that is conducted as if they were unrelated, so that there is no conflict of interest”. Arm's length basis does not imply arm's length pricing because there are other factors that must be taken into account in addition to price, which is just one aspect of the terms of dealing with the other party.

In the famous case of *Madhu Ashok Kapur & Ors. V. Rana Kapoor*²¹, in which the appointment of Managing Director was questioned on the arm's length basis. However, the court adopted a liberal interpretation and emphasised on fairness of the transaction instead of rigid procedure. The court emphasised that an arm's length transaction must reflect market standards in order to ensure that the transaction is fair and impartial. The court in this case looked at the terms and conditions of appointment and instead of strictly adhering to the procedure prescribed, the court looked at whether the appointment was in consistency with the industry norms and free from undue influence. Based on this, the court held that the appointment was indeed at an arm's length.

²⁰ AIR1950 Bom 200

²¹ MANU/MH/1038/2015

In *A.K. Roy v. Voltas Ltd.*,²² the court pointed out that just because the agreement specifies benefits does not imply that the transaction is not at arm's length as long as they can prove that the terms are fair, reasonable, and negotiated commercially. Additionally, the court noted that transaction volume is irrelevant.

Although the concept of “arm's length basis” is one of the most crucial ways to guarantee that transactions are fair in their handling, its legal definitions have frequently been unclear. Nonetheless, the court has repeatedly stressed that such transactions must include terms that would be applicable between unrelated parties in comparable situations. But in a practical scenario it is very difficult to find the right comparable price even in common transactions and for complex transactions is a bigger challenge. So, various tools are used like valuation reports, valuation techniques or methods prescribed under transpiring OECD Regulations. One such method is the “Profit Split Method” which is invariably used in many cases.

PROFIT SPLIT METHOD

Obtaining an accurate comparable pricing is challenging even for standard related party transactions, and it becomes significantly more difficult for unique transactions. Sometimes businesses engage in transactions that are too closely related to be examined separately. Example- Two related organisations might collaborate on a joint venture, such as introducing a new brand. In such kinds of transactions, Profit Split Method (“PSM”) can be used to determine how profits will be distributed in a way that is equitable to both organisations by examining the total profits of two related parties entering into a transaction with one another.

Profit Split Method can be applied in three different ways:²³

- 1. Comparable Profit Split Method:** To implement the comparable profit split approach, affiliated companies must identify a comparable transaction in which two connected entities share earnings, thereafter utilising it as a benchmark for the allocation of their own profits.

²² 1973 AIR 225

²³ OECD (2022), OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022, OECD Publishing, Paris, <https://doi.org/10.1787/0e655865-en>.

- 2. Contribution Profit Split Method:** When using the contribution profit split method, the respective financial or other contributions made by the two businesses involved in a transaction are examined. These contributions are then used to determine a reasonable profit share.
- 3. Residual Profit Split Method:** The residual profit split technique divides overall profits according to each party's investments and relative expenditures after deducting the earnings from both parties' ordinary operations, which are calculated using the comparable profits approach

RECENT DEVELOPMENTS:

A. INDUSTRY STANDARD FORUM

In accordance with the provisions of Regulation 23(2), (3) and (4) of the SEBI (LODR) Regulations, 2015, prior approval of the Audit Committee and shareholders, as the case may be, is required for the Related Party Transactions.

In the year 2025, SEBI vide its circular, introduced Industry Standards on "Minimum information to be provided for review of the audit committee and shareholders for approval of related party transactions".²⁴ The Industry Standards Forum ("ISF") is composed of representatives from three industry associations, viz. ASSOCHAM, CII and FICCI, under the aegis of the Stock Exchanges, had formulated these industry standards, in consultation with SEBI.

To strengthen RPT governance, SEBI has supported the creation of Industry Standards effective from 1 September 2025. By requiring minimum disclosures and documentation for audit committee and shareholder review, these guidelines seek to enhance decision-making, clarity, and consistency regarding important RPTs.

In order to successfully comply with these criteria, listed organisations must evaluate and modernise their existing procedures. It aimed to bring enhanced clarity and operational feasibility while maintaining the integrity of shareholder protection disclosure to be provided to the audit company and to shareholders before seeking approval for RTPs.²⁵

²⁴ Minimum information to be provided to the Audit Committee and Shareholders for approval of Related Party Transactions. Circular No. SEBI/HO/CFD/CFD-PoD-2/P/CIR/2025/135

²⁵ Industry Standards for RPT Disclosures: A Game Changer for Corporate Governance by ICSI

B. The SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 were recently modified by the Securities and Exchange Board of India by announcing the SEBI (Listing Obligations and Disclosure Requirements) (Fifth Amendment) Regulations, 2025 on November 18, 2025.

The Amendment Regulations revise the related party transactions framework for listed entities.²⁶

1. Introduction of New Schedule XII

The amendment introduces a new scale based materiality threshold based on the turnover of the listed entity for determining material RPTs by inserting Schedule XII. However, the materiality threshold for RPTs involving royalty payments remain unchanged at 5% of the annual consolidated turnover of the listed entity as per its last audited financial statements.

Consolidated Turnover of Listed Entity	Threshold
Up to ₹20,000 crore	10 percent of consolidated turnover
Above ₹20,000 crore and up to ₹40,000 crore	₹2,000 crore plus 5 percent of the turnover in excess of ₹20,000 crore
Above ₹40,000 crore	₹3,000 crore and 2.5 percent of the turnover in excess of ₹40,000 crore, subject to an overall cap of ₹5,000 crore

Prior to amendment, rupees one thousand crore or ten percent of the annual consolidated turnover of the listed entity as per the last audited financial statements of the listed entity, whichever is lower was considered material RPT.

2. Revised thresholds for determining material RPTs for subsidiaries

The listed entity's Audit Committee now has more authority over RPTs conducted at the subsidiary level due to an amendment to the second proviso of Regulation 23(2).

²⁶ Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) (Fifth Amendment) Regulations, 2025. F. No. SEBI/LAD-NRO/GN/2025/273

- Where subsidiary has at least one year of audited standalone financial statements, any transaction with a related party of the listed entity or of such subsidiary; to which only the subsidiary is a party; and whose value exceeds rupees one crore, requires prior approval of the listed entity's Audit Committee if the value exceeds the lower of:
 - (a) 10 % of the annual standalone turnover of the subsidiary (as per its last audited standalone financial statements); and
 - (b) the materiality threshold prescribed for the listed entity in Schedule XII
- Where subsidiaries do not have audited financial statements for a period of at least one year, an RPT above rupees one crore requires prior Audit Committee approval if it exceeds the lower of:
 - (a) 10 % aggregate of the paid-up share capital and securities premium account of the subsidiary; and
 - (b) the listed entity's Schedule XII materiality threshold.

3. Tenure Of Shareholder Approvals

Amendment to regulation 23(4) has fixed the tenure of omnibus shareholder approvals for material RPTs as where approval is obtained at an Annual General Meeting (AGM), it is valid only until the next AGM held within the timelines prescribed under the Companies Act, 2013 and where approval is obtained in any other general meeting, its validity is up to one year from the date of that meeting.

4. Clarification for Holding Company

Explanation has been inserted after clause (e) of Regulation 23(5), clarifying that the term "holding company" in that provision refers deemed to be referred to as a listed holding company.

CONSEQUENCES OF NON-COMPLIANCE:

Section 134(3)(h)²⁷ of the Companies Act, 2013, along with Rule 8(2) of the Companies (Accounts) Rules 2014, requires companies to include particulars of contracts or arrangements

²⁷ The Companies Act, 2013 (Act No. 18 of 2013) s. 134.

with related parties in the Board's report. Failure to comply results in penalties as stipulated in Section 134(8) of the Act.

Sub-section (5) of section 188 of the 2013 Act provides for punishment for violating the provisions of the section. In case of a listed company, any director or any other employee of a company, who had entered into an arrangement in violation of the provisions of section 188 shall be liable to a penalty of twenty five lakh rupees and in case of any other company, he will be liable to a penalty of five lakh rupees.

PRACTICAL CHALLENGES:

Some of the key issues include:

- a. **Obstacle in determining Related Party:** It can be very difficult to regularly monitor individuals whose shareholding exceeded the prescribed threshold during the previous financial year, particularly when it comes to public shareholders to determine related parties.
- b. **Fluctuating Shareholdings:** The shareholding of large public investors can vary significantly from year to year. As a result, a shareholder who holds a relatively small or no stake in the current year could still be categorized as a related party if they had 10% or more ownership at any point during the previous year.
- c. **Identify all the related party transactions:** There can be some transactions which are left behind for scrutiny in the related party transactions as a group company does a number of deals everyday. So it becomes challenging to examine every transaction on the threshold of related party transactions.
- d. **Broad Definition of 'Promoter Group':** The definition of the 'promoter group' is extensive, which can lead to unexpected consequences. For example, investors with minority portfolio holdings might be incorrectly classified as related parties if they fall within this broad scope.

WAY FORWARD

Alignment of Price with respect to risk, contribution and value creation: The relative contribution of each party whether in terms of capital, intellectual property, managerial expertise, or operational support must be carefully assessed. Pricing should reward value-adding functions rather than

merely capital ownership. Transactions involving unique or high-value assets (such as intangibles, brand value, or proprietary technology) require specialized valuation approaches to ensure equitable compensation.

Employing technology: Advanced data analytics tools can map relationships across entities, directors, and shareholders, enabling real-time identification of related parties and potential RPTs. Artificial Intelligence can be used to flag unusual transaction patterns, detect anomalies, and assess the likelihood of conflicts of interest.

Listed Companies need to change their policies: Companies must develop detailed policies clearly defining approval mechanisms, materiality thresholds, and documentation requirements in line with recent regulatory amendments.

CONCLUSION

In corporate governance, related party transactions play a paradoxical role since they are both necessary for smooth operations and a possible source of abuse. Effective regulation of these transactions is more difficult than outright banning them.

To address these issues, India's regulatory structure has changed dramatically, especially under the Companies Act, 2013 and SEBI (LODR) Regulations. There has been a noticeable shift toward more accountability and openness with recent changes, such as the implementation of improved disclosure standards and established materiality levels. The intent of new disclosure requirements is precisely to maintain uniformity in the information furnished to audit committees and shareholders across listed entities. At the same time these standards also make the management and the board more accountable for critically relooking at the existing RPT Process and their pricing.

However, regulatory compliance is not enough on its own. Businesses need to have a comprehensive governance strategy that incorporates strong internal policies, innovative technology, and fair pricing principles. Only then will it be possible to accomplish the two goals of supporting lawful company activities and safeguarding the interests of minority shareholders.