



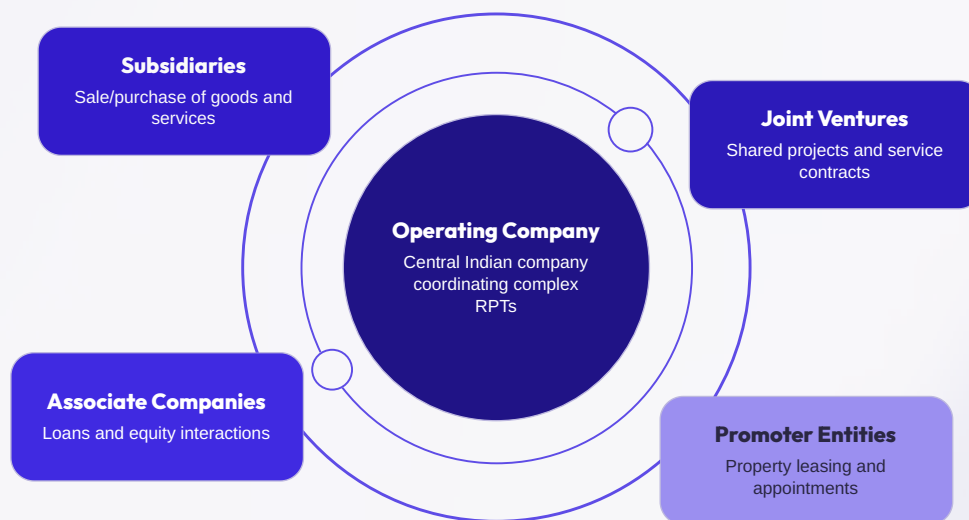
AZVIZORY

Related Party Transactions in India: Compliance, Risk and Practical Management for Startups & MSMEs

Understanding Related Party Transactions (RPTs) in India

Defining Related Party Transactions (RPTs)

- RPTs are interactions between a company and entities connected through control, ownership, or key management personnel (KMP) relationships.
- These connections form the intricate fabric of India's corporate world.



Scope of "Related Party"

Broadly defined under the Companies Act, 2013, and SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

Extends beyond direct ownership to include:

- Key Managerial Personnel (KMP) and their relatives
- Entities where KMP hold significant influence or directorship

Examples: Transactions with Subsidiaries, Joint Ventures, Associate Companies, Director-owned firms, and Promoter-affiliated companies.



Common Types of RPTs

- Sale or purchase of goods and services
- Leasing of property
- Underwriting of securities
- Appointment of related parties to any office or place of profit

Examples: A fintech startup using cloud services from a founder's IT company, or an e-commerce MSME leasing warehouse space from a promoter's real estate firm, or a food delivery startup hiring logistics services from a co-founder's transport business.



Strategic Purpose of RPTs

Often driven by legitimate business needs:

- Operational efficiency
- Cost synergies
- Leveraging specialized expertise within a group

However, because these transactions carry the risk of conflicts of interest, they require strict transparency and regulatory oversight to protect the interests of shareholders and maintain market integrity.

Examples: A parent company selling raw materials to its subsidiary at market rates to streamline supply chain operations, or a joint venture appointing a director from one of its promoter companies to oversee specialized project management.

Why RPT Governance is Crucial for Startups & MSMEs



Enhanced Investor Confidence

Robust RPT governance attracts investment; investors scrutinize controls. Lack of transparency is a red flag, with over 20% of M&A deals delayed or failed due to governance concerns. A clear framework shows maturity and reduces risk.



Regulatory Resilience & Compliance

Meeting compliance requirements proactively avoids penalties and reputational damage. Strong RPT governance ensures your company meets current and future obligations under acts like the Companies Act, 2013.



Streamlined Exit Strategy

Clear RPT records and transparent governance make your company more attractive to potential acquirers or investors during an exit event (e.g., M&A, IPO). It reduces due diligence risks and can increase valuation.



Future Funding Readiness

Proper RPT governance is critical for securing institutional funding rounds (Series A, B, C), as investors and lenders conduct thorough due diligence on governance practices, and weak RPT controls can be a deal-breaker for funding.



Operational Clarity & Risk Mitigation

Formal RPT processes transform informal group support (shared services, loans) into documented value. This defines terms, prevents conflicts, ensures "arm's length" dealings, and protects shareholders.



Tax Certainty

Proper documentation and adherence to arm's-length principles are vital for inter-company transactions, especially cross-border ones. A strong RPT policy reduces transfer pricing disputes and ensures financial planning certainty.



Pre-IPO Readiness

Proper RPT governance is essential for companies preparing for IPO, as SEBI scrutinizes RPT practices during the listing process. Having robust systems in place accelerates the IPO timeline and reduces regulatory queries.



Sustained Competitive Advantage

Ethical RPT governance fosters a culture of integrity and trust, enhancing your brand reputation. This differentiates your startup or MSME in the market, attracting better talent, partners, and customers, leading to long-term growth.

Legal and Regulatory Framework Governing RPTs

Companies Act, 2013

Section 188 mandates Board approval for RPTs.

- Shareholder approval for high-value transactions.
- Dealings must be at arm's length.

SEBI LODR Regulations, 2015

Applies to listed companies, requiring enhanced disclosure and stringent audit committee oversight for RPTs.

- Expanded scope and tightened scrutiny.
- Stricter materiality thresholds for transactions.

Ind AS 24: Related Party Disclosures

Mandates comprehensive disclosure of related party relationships and transactions in financial statements.

- Identifies key management personnel as related parties.
- Ensures transparency of RPT effects on financial position.

ICAI Guidance & Auditing Standards

ICAI provides interpretations and ethical guidance for auditors to ensure proper scrutiny of RPTs.

- Adherence to Auditing Standard (SA) 550.
- Focus on assessing risks of material misstatement.

Sector-Specific Regulations (RBI & IRDAI)

RBI (banking) and IRDAI (insurance) issue specific prudential norms and governance guidelines for RPTs.

- RBI focuses on exposure limits and lending restrictions.
- IRDAI regulates investments and protects policyholder interests.

Income Tax Transfer Pricing Rules

Section 92 mandates arm's-length principle for international and specified domestic transactions to prevent profit shifting.

- Requires documentation (master file, local file).
- Includes Safe Harbour rules for simplified compliance.

RPT Regulations: Applicability for Startups & MSMEs

Understanding which Related Party Transaction (RPT) regulations apply is crucial for startups and MSMEs. While some rules are universal, others depend on size, sector, and operational scope as mentioned below:

Regulation	Applicability Criteria	Key Requirements	Compliance
Companies Act, 2013	All companies registered in India, regardless of size or listing status.	Board approval for RPTs. Shareholder approval for high-value RPTs.	Mandatory
SEBI (LODR) Regulations, 2015	Primarily listed public companies . Not directly applicable to unlisted startups/MSMEs, unless it becomes part of listed parent entity	Enhanced disclosure and audit committee oversight. Adopt best practices if planning IPO or seeking significant investment .	Mandatory (if listed); Best Practice (if aspiring to list)
Income Tax Act (Transfer Pricing)	All entities (including startups/MSMEs) with international related party transactions or specified domestic transactions .	Arm's length principle for pricing transactions. Maintain detailed documentation	Mandatory (if applicable transactions exist)
Ind AS 24: Related Party Disclosures	Certain companies based on net worth, turnover, and listing status . May not apply to many MSMEs initially.	Comprehensive disclosure of related party relationships and transactions in financial statements .	Mandatory (if criteria met)
RBI Guidelines	Financial entities regulated by the Reserve Bank of India (e.g., NBFCs, Payment Banks, some FinTechs).	Specific prudential norms, exposure limits, and lending restrictions related to RPTs.	Mandatory (if RBI-regulated)
IRDAI Guidelines	Entities regulated by the IRDAI (e.g., insurance companies, insurance intermediaries).	Regulations concerning investments, governance, and protection of policyholder interests in RPTs.	Mandatory (if IRDAI-regulated)

Navigating these regulations requires balancing strict adherence to mandatory laws with adopting best practices for growth, investor confidence, and regulatory resilience.

Navigating RPTs: Key Challenges for Startups and MSMEs

1 Identifying Related Parties in Informal Structures

For startups and MSMEs, close-knit founding teams, family involvement, and informal investor networks can blur lines, making it challenging to formally identify all related parties without robust systems or clear policies.

2 Proving Arm's Length Transactions

Without dedicated finance teams or budgets for independent valuations, proving that RPTs are at fair market value can be a significant burden, leading to potential scrutiny and difficulty in demonstrating compliance.

3 Unintentional Disclosure Gaps

Smaller companies often lack awareness of specific RPT disclosure mandates or the resources to maintain detailed records, leading to unintentional non-compliance and potential regulatory penalties due to oversight.

4 Resource Constraints for Compliance

Founders and limited management in startups and MSMEs often bear the compliance burden without specialized knowledge or dedicated staff, diverting critical time and resources from core business activities.

5 Protecting Smaller Investors' Interests

Safeguarding the interests of minority shareholders, including angel investors or early co-founders, against potential exploitation through RPTs requires transparent processes and clear agreements from the outset.

6 Reputation and Trust Erosion

Perceived or actual unfair RPTs can disproportionately damage a small company's budding reputation, erode investor confidence, and impact its ability to raise future funding or secure partnerships.

Framework for Effective RPT Management

IDENTIFY — make it routine

Establish a monthly updated Related Party Register, identifying RPT types such as sales, loans, and shared services.

VALUATION & PRICING — evidence arm's-length

Document benchmarking and transfer-pricing methods for all material transactions to demonstrate arm's-length pricing.

DISCLOSE & REPORT — be transparent

Prepare concise RPT summaries for quarterly board packs and external disclosure, aligning with industry standards where applicable.

POLICY — set clear guardrails

Adopt a Board-approved RPT Policy outlining definitions, approval thresholds, documentation, and arm's-length principles. Set annual caps for low-value transactions.

APPROVAL WORKFLOW — make approvals disciplined

Implement a digital workflow capturing deal summary, rationale, pricing, conflicts, and required sign-offs for all approvals.

MONITOR & AUDIT — create simple controls

Use a monthly dashboard to monitor RPTs by type and value, with quarterly internal and annual independent audits for material transactions.

Establishing these comprehensive measures helps mitigate risks of conflicts of interest, ensures compliance with regulations, and fosters stakeholder trust in the integrity of related party dealings.

Regular training for relevant staff on transfer pricing rules and conflict-of-interest policies further strengthens governance, while ongoing review and adaptation of procedures ensure responsiveness to evolving legal and market environments.

Managing International Related Party Transactions (RPTs)

Cross-border RPTs inherently invite intensified tax scrutiny and complex foreign exchange and regulatory considerations. This checklist outlines key steps for effective management:

A. Pre-Deal Due Diligence

- Determine if **transfer pricing (TP) documentation** is applicable, considering varying thresholds based on transaction type and year. If so, strategically plan benchmarking and select the appropriate TP method before deal finalization.
- Assess potential **Foreign Exchange Management Act (FEMA)** implications for all loans, guarantees, and capital movements.

B. Ensuring Defensible Pricing

- Utilize contemporaneous benchmarking or an Advance Pricing Agreement (APA) in scenarios with high uncertainty. Monitor CBDT notifications for safe harbour rules and updated sectoral lists, which may offer relief for specific financial years or segments.

C. Comprehensive Documentation

- Establish a contemporaneous TP file, including: contract details, comparable analyses, functional analysis, economic rationale, intercompany invoice copies, and ongoing monitoring reports. Ensure retention of evidence for arm's-length adjustments and all requisite approvals.

D. Currency and Risk Mitigation Clauses

- Incorporate currency fluctuation clauses and dispute/adjustment mechanisms, linked to periodic benchmarking, particularly for long-term contracts.

E. Local Compliance & Withholding Tax

- Confirm withholding tax and Goods and Services Tax (GST) implications in both India and the recipient jurisdiction. Include tax gross-up clauses where necessary.

Practical Actionables: A 30/60/90 Day Checklist for MSMEs & Startups

Establishing robust Related Party Transaction (RPT) management processes is crucial for MSMEs and startups to ensure compliance and minimize risks. This actionable checklist provides a structured approach for the first 90 days.

1

Days 1–30: Laying the Foundation

Establish core ownership and initial policy frameworks.

- **Appoint RPT Owner:** Designate a senior individual responsible for RPT oversight.
- **Draft RPT Policy:** Outline related parties, transaction types, approvals, and documentation.
- **Initiate Related Party Register:** Compile a list of related parties and existing transactions.

2

Days 31–60: Operationalizing & Testing

Implement workflows and validate processes.

- **Implement Digital Approval Workflow:** Set up an efficient digital system for RPT documentation and approval.
- **Run Historical RPT Samples:** Apply new policy/workflow to historical RPTs and prepare pricing memos.
- **Internal Communication:** Educate key personnel on RPT policy and procedures.

3

Days 61–90: Finalization & Ongoing Monitoring

Secure formal approvals and establish continuous oversight.

- **Finalize Policy & Board Sign-off:** Present refined RPT policy to the Board for formal approval.
- **Commence Monthly RPT Dashboard Reporting:** Establish monthly reporting for RPT activities, volumes, and compliance.
- **Cross-Border Transaction Assessment:** Initiate preliminary transfer pricing studies for recurring cross-border RPTs.

Azvizory's Solutions: Empowering Transparent and Compliant RPT Governance for Growth

Azvizory provides an end-to-end RPT governance package tailored specifically for startups and MSMEs, addressing their unique needs, resource constraints, and growth stages:



Simplified RPT Health Check & Setup

Get a clear overview of your current RPT status, identify basic risks, and establish a foundational register for easy compliance.



Tailored Policies & Efficient Workflows

Implement practical, easy-to-follow RPT policies and digital approval templates to ensure consistent and compliant transactions without heavy administrative burden.



Fair Pricing & TP Guidance

Ensure all related party transactions are conducted at arm's length, helping to minimize tax risks and regulatory scrutiny, scaled appropriately for your business.



Founder & Key Team Training

Essential, practical training for founders and key management on RPT compliance basics, relevant regulations, and how to spot potential red flags as your business grows.



Investor & Basic Disclosure Support

Craft clear and concise RPT summaries for potential investors and navigate early disclosure requirements, translating complex regulations into simple terms.



Proactive Advisory & Review

Stay updated on regulatory changes relevant to smaller businesses and ensure your RPT policies evolve effectively, providing peace of mind and continuous compliance.

Conclusion: Navigating the Future of Related Party Transactions with Confidence

RPTs are essential to Indian corporate operations but require careful governance to balance business needs with regulatory compliance. Success demands more than compliance—it requires strategic thinking, proactive governance, and innovative solutions that build stakeholder trust and enable sustainable growth.

Azvizory stands ready to partner with organisations in this transformative journey, delivering cutting-edge solutions that simplify RPT management, enhance transparency, and empower boards and shareholders alike. Together, we can build a more transparent and resilient corporate ecosystem.



1

Strategic Partnership

Join Azvizory in transforming RPT governance from compliance burden to competitive advantage

2

Future-Ready Solutions

Embrace technology-driven frameworks that prepare your organization for tomorrow's challenges

3

Sustainable Growth

Position your company for long-term success in India's dynamic and evolving market environment

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