

Nishith Desai Associates
LEGAL AND TAX COUNSELING WORLDWIDE

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SIGNIFICANT BENEFICIAL OWNERSHIP

NOVEMBER, 2018

- distinctly different

Overview

1. SBOs under the Companies Act
2. SBO Rules, 2018
3. SBOs Under Other Regimes
4. Companies Act (Amendment) Ordinance, 2018



SBOs UNDER THE COMPANIES ACT

SBOs under the Companies Act

- The requirement of identifying and declaring SBOs is not new to the Companies Act, 2013.
- Section 187C of the Companies Act, 1956 was the precursor to Sections 89 and 90 (discussed later) of the Companies Act, 2013.
- Section 187C provided for declaration by a person entered into the register of members as the holder of a share and yet not holding the beneficial interest, declaration by the person who holds beneficial interest and an obligation on the company to note such declarations in the register of members.
- The manner of declaration was subsequently notified in 1975 when the Companies (Declaration of Beneficial Interest in Shares Rules), 1975 was notified.
- Non-compliance on the part of the persons required to make declarations to do so could subject them to a fine of INR 1000 per day of default. Similarly, non-compliance on the part of the company could subject the officer in default to a fine of INR 100 per day of default.
- 2 aspects which were not present in the Companies Act, 1956 were
 - Ability of the company to seek information relating to beneficial ownership; and
 - Ability to approach judicial authorities.

SBOs under the Companies Act

- The provisions relating to SBO under the Companies Act, 2013 are primarily contained under Sections 89 and 90
- Section 89 requires declarations in respect of the following:
 - Declaration from a person whose name is entered in the register of members as a shareholder, but who does not hold the beneficial interest in such shares
 - Declaration from the holder / acquirer of beneficial interest
 - Declaration of change in beneficial interest from both of the above
- Failure to make the aforesaid declarations could subject a person to a fine of up to INR 50,000 + INR 1,000 per day of default
- A company receiving the aforesaid declaration(s) is required to take note of the same in the concerned register and file with the RoC within 30 days of such receipt. Non-compliance can subject the company and the officer in default to a fine of INR 500 – INR 1,000 + INR 1,000 per day of default
- Further consequences of non-declaration – unenforceability of such right in respect of which a declaration is required to be made but not made

SBOs under the Companies Act

- In 2017, Section 89(10) was introduced to define “beneficial interest” under Sections 89 and 90. It has been effective from its notification on May 7, 2018. “Beneficial interest” in a share includes, directly or indirectly, through any contract, arrangement or otherwise, the right or entitlement of a person alone or together with any other person to:
 - Exercise or cause to be exercised any or all of the rights attached to such share; or
 - Receive or participate in any dividend or other distribution in respect of such share
- Clearly, the definition of “beneficial interest” is very wide, purportedly to cover a wide range of interests, stemming ostensibly from the same place as other BO rules i.e. prevention of money laundering
- Importantly, among many changes introduced by way of the 2017 amendment, Section 90 was introduced to the Companies Act, 2013 relating to the register of SBOs.
- Section 90 imposes an obligation to make a declaration as prescribed on every individual, who acting alone or together, or through one or more persons or trust (including non-residents), holds beneficial interest (such individual being the “**SBO**”) of:
 - not less than 25% (now reduced to 10% under the rules) in shares of a company; or
 - the right to exercise, or actual exercise of, significant influence over a company
 - the right to exercise, or actual exercise of control over a company

SBOs under the Companies Act

Criteria for identification of SBOs are

(Section 90)

25% of the shareholding of the company

Right or the actual exercise of control

Right or the actual exercise of significant beneficial interest

- Section 2(27) defines “control” as including the right to appoint a majority of directors or control the management or policy decisions by person(s), directly or indirectly, including through shareholding / management rights / SHAs etc.
- Section 2(6) defines “significant influence” to mean control of at least 20% of the total voting power, or control or participation in the business decisions under an agreement
- Failure to make a declaration by an SBO can attract imprisonment for upto 1 year (as per the 2018 Ordinance to be discussed) a fine of INR 1,00,000 – INR 10,00,000 + INR 1,000 per day of default

SBOs under the Companies Act

- Section 90 requires that every company shall maintain a register of interest declared by SBOs
- Such register shall be open to inspection by any member of the company
- A company is also required to file a return of SBOs
- In an addition to the position under the Companies Act, 1956, Section 90 provides for a company to give notice to any person (including non-members) whom the company knows or has reasonable cause to believe:
 - To be an SBO
 - To have knowledge of SBOs
 - To have been an SBO in the preceding 3 years (from the notice date) and who is not registered as an SBO
- A person receiving such notice is required to provide the information required within 30 days
- In case a person to whom such notice has been issued does not respond within 30 days or where the information is not satisfactory, the company shall apply to the NCLT for an order directing that the shares be subject to restrictions on transfer of interest, suspension of attached rights etc. A person aggrieved by the NCLT's order may apply for relaxation / lifting of the restrictions within 1 year from the date of the order (time period introduced by the 2018 Ordinance)

SBOs under the Companies Act

- Failure on the part of a company to maintain the SBO register or to file the required information can subject the company and every officer in default to a fine of INR 10,00,000 – INR 50,00,000 + INR 1,000 per day of default
- Willful supply of false / incorrect information or willful suppression of material information can make a person liable for action under Section 447 – which deals with fraud (in the context of the Companies Act), with imprisonment of 6 months – 10 years + fine of the amount of x to 3x of the amount involved in the fraud



SBO RULES, 2018

SBO Rules, 2018

- Pursuant to the introduction of Sections 90 and 89(10), the MCA notified the Companies (Significant Beneficial Ownership) Rules, 2018 (“SBO Rules”)
- Importantly, the SBO Rules further layered the meaning of SBO as follows:
 - An individual as referred to in Section 90(1)
 - Having ultimate beneficial ownership of not less than 10% (therefore reduced from 25%) of shares
 - Read with Section 89(10)
 - Whose name is not entered in the register of members with respect to such shares
- The SBO Rules define a “registered owner” as a person whose name is entered in the register of members as the holder of shares but who does not hold the beneficial interest
- It is pertinent to note that for the purpose of UBO identification, including SBO thresholds, GDRs, CCPS, CCDs are included as “shares”. Beyond the mandate of the provisions of Sections 89 and 90 with respect to GDR and CCDs?
- The SBO Rules further prescribe the nature of determination of SBO in case of persons other than individuals or natural persons

SBO Rules, 2018

- In case where a Company is the shareholder, the SBO is the natural person who,
 - holds not less than 10% of the share capital of that company or;
 - who exercises significant influence or control in the company through other means

It is pertinent to note here that the 10% holding needs to be held in the investor company and not the investee company. In this manner, a person holding less than 2% (eg: 11% of a 11% holder) can also be identified as an SBO

- In case where a Partnership Firm is the shareholder, the SBO is the natural person who,
 - is entitled to 10% of the profits of the partnership firm or;
 - who exercises significant influence or control over the partnership firm through other means
- However, if no natural person is identifiable for a company / firm, the SBO of the investee company would be the relevant natural person who holds the position of senior managing official (“SMO”)
- In cases where the shareholder is a trust (acting through its trustee),
 - the SBO identification shall include the (i) settlor, (ii) trustee or (iii) beneficiaries with not less than 10% interest in the trust and (iv) any other natural persons exercising ultimate effective control over the trust through a chain of control or ownership.

SBO Rules, 2018

Disclosures under the SBO Rules

Form BEN -1



Declaration by SBOs to the company regarding acquisition / change in significant beneficial ownership within 90 days of commencement of Rules or 30 days of change

Form BEN -2



Declaration by company regarding declarations received within 30 days of receipt of declaration

Form BEN -3



Company is required to maintain a register of SBOs. Open for inspection for members with 2+ hours notice

Form BEN -4



Notice seeking information by a company on persons it has reasonable cause to believe to be SBOs

SBO Rules, 2018

- In case of non-response / unsatisfactory response by a person to a notice received from a company with reasonable cause to believe such person to be an SBO / know the identity of an SBO / have been an SBO as discussed earlier, the company shall make an application to the NCLT to pass any order directing:
 - restrictions on the transfer of interest attached to the shares in question;
 - suspension of the right to receive dividend in relation to the shares in question;
 - suspension of voting rights in relation to the shares in question;
 - any other restriction on all or any of the rights attached with the shares in question
- The SBO Rules provide that they shall not be applicable to holding of shares of companies in case of pooled investment vehicles / investment funds such as mutual funds, AIFs, REITS, InvITs. It remains unclear whether such exemption extends to offshore pooling vehicles / investment funds



SBOs UNDER OTHER REGIMES

SBOs Under Other Regimes

PMLA Rules

- Rule 9 of the Prevention of Money Laundering (Maintenance of Records) Rules, 2005 (“PMLA Rules”, promulgated under the Prevention of Money Laundering Act, 2002 use a “look through” approach focusing on the person undergoing the KYC i.e. the client. Accordingly, the following guidance is provided:
 - where the client is a company, the beneficial owner is the natural person(s), who, whether acting alone or together, or through one or more juridical person, has a controlling ownership interest or who exercises control through other means...
 - Controlling ownership interest” means ownership of or entitlement to more than 25% of shares or capital or profits of the company;
 - “Control” shall include the right to appoint majority of the directors / control the management /policy decisions including by virtue of their shareholding / management rights / SHAs / voting agreements
 - where the client is a partnership firm, the beneficial owner is the natural person(s) who, whether acting alone or together, or through one or more juridical person, has ownership of / entitlement to more than 15% of capital or profits of the partnership
 - where the client is an unincorporated association or body of individuals, the beneficial owner is the natural person(s), who, whether acting alone or together, or through one or more juridical person, has ownership of or entitlement to more than 15% of the property or capital or profits of such client
 - If no natural person is identified based on the above, the beneficial owner is the SMO

SBOs Under Other Regimes

PMLA Rules

- where the client is a trust, the identification of beneficial owner(s) shall include identification of the author of the trust, the trustee, the beneficiaries with fifteen per cent. or more interest in the trust and any other natural person exercising ultimate effective control over the trust through a chain of control or ownership; and
- where the client or the owner of the controlling interest is a company listed on a stock exchange, or is a subsidiary of such a company, it is not necessary to identify and verify the identity of any shareholder or beneficial owner of such companies

SEBI FPI Regulations

- SEBI recently, through the issuance of the “**KYC Circular**” on September 21, 2018, revised its framework relating to carrying out KYC for FPIs and in the process, for identification of UBOs for FPIs. SEBI has mandated the presentation of information in 2 annexures – Annexure A and Annexure B
 - Annexure A – Identification of BOs as per the PMLA Rules. In respect of FPIs coming out of high-risk jurisdictions, the threshold is reduced to 10%
 - Annexure B – Identification of BOs and intermediate holder / entity above the materiality threshold on a look through basis. Relaxed for Category I FPIs
 - Foreign companies ineligible for listed company exemption under PMLA Rules
 - ODI issuing FPIs required to identify BOs of ODI subscribers

SBOs Under Other Regimes

Unlike the SBO Rules, the other prominent regimes in India in relation to UBO identification employ a look through approach

FATF

- Beneficial owner refers to the natural person(s) who ultimately owns or controls a customer and/or the natural person on whose behalf a transaction is being conducted. It also includes those persons who exercise ultimate effective control over a legal person or arrangement. Reference to “ultimately owns or controls” and “ultimate effective control” refer to situations in which ownership/control is exercised through a chain of ownership or by means of control other than direct control
- This understanding of beneficial owner has been adopted (with appropriate modifications) by many regimes around the world, including UK, US and EU

SBOs - TOPICS FOR DISCUSSION

- Interface with investment documentation – clauses such as liquidation preference, RoFR, RoFO
- Pledge
- Transfer pending registration
- Lowering of threshold to 10% and identifying holders of intermediate entities having interest of 10+% in the intermediate entity and not the company (being assessed) can lead to declaration of SBOs who do not control / own a company substantially and are yet identified. Similarly, natural persons entered in the register and who can exercise control / ownership (such as a natural person holding 50+% of the shares) are not required to be identified
- Expansion of meaning of “shares” beyond the contemplation of Sections 89 and 90
- Entities for whom ascertainment of beneficial ownership may be difficult – listed companies, offshore funds set up as companies
- Identification of SMO as SBO and associated issues



COMPANIES (AMENDMENT) ORDINANCE, 2018

Companies Act (Amendment) Ordinance, 2018

On November 2, 2018, the Companies (Amendment) Ordinance, 2018 was introduced, effecting certain significant changes (changes with respect to SBOs have been discussed above) which may be categorized as follows:

- Relaxation of penalties, including for the following offences
 - Violating the prohibition of issue of shares at a discount
 - Failure / delay in filing notice for alteration of share capital
 - Failure / delay in filing annual return
 - Failure in provision of notice by auditor post resignation
 - DIN related contraventions
 - Violation of limits on managerial remuneration
- In some cases, such as the following, stiffer penalties have been provided
 - Failure to comply with the order of the adjudicating officer / Regional Director
 - Repeated default under the provisions of the Companies Act, 2013

Companies Act (Amendment) Ordinance, 2018

Salient Features of the Ordinance:

- Relieving the NCLT pendency
 - Increased pecuniary limits for compounding of offences by the Regional Director
 - Power to approve alteration in financial year transferred from the NCLT to the Central Government
 - Power to approve conversion of public companies to private companies transferred to the Central Government
- Other measures
 - Reintroduction of declaration for commencement of business / exercise borrowing power
 - Physical verification of registered office by RoC and removal of name in case of default
 - Enhanced punishment in respect of maintaining Register of SBOs
 - Disqualification for persons accepting directorships in excess of the prescribed maximum

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