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Significant Beneficial Owners

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A Significant Beneficial Owner, according to the Ministry of Corporate Affairs, is someone who has a big percentage of the company's voting rights but no direct control. Following the recommendations of the Financial Action Task Force and the Company Law Committee, the Central Government implemented Substantial Beneficial Ownership by amending Section 90 of the Companies Act, 2013 ('Act') with the Companies (Amendment) Act, 2017. Section 90 requires any individual who, acting alone, jointly, or through one or more persons, including trusts and persons residing outside India, holds a beneficial interest in shares of a company of at least 25% or another prescribed percentage, or the right to exercise or the actual exercise of significant influence or control under Section 2(27) of the Act, to declare to the company (SBO). In this paper, the concept of SBO will be discussed with all the relevant sections and amendment rules and also the challenges or the issues that concern the understanding of SBO.

Keywords: *significant beneficial owner, control, significant, equity shares.*

INTRODUCTION

Beneficial ownership is defined as ownership that eventually benefits from the asset's revenue and has control over it. The Ministry of Corporate Affairs, the entity in charge of enforcing Indian corporate law, published guidelines in 2019 for recognizing substantial beneficial ownership/ownership in Indian firms. Although beneficial ownership has been recognized in

Indian corporate law for many years, it was primarily based on registered shareholders' *suo moto* admissions that someone else possessed the beneficial interest in those shares.

Section 90(1) of the Act¹ defines a person as a significant beneficial owner if they "directly or indirectly, whether alone or with one or more other persons or trusts, including trusts and persons resident outside India, hold beneficial interests in company shares of at least 25% or any other specified percentage, or the right to exercise, or the actual exercise, of significant influence or control, as defined in the Act. The limits under this paragraph may be relaxed at the discretion of the Central Government for specified categories. For example, if Mr. Ajay owns more than half of the shares in ZMD Limited and ZMD Limited owns 12% of the shares in OPQ Limited, he has Substantial Beneficial Ownership in OPQ Limited.

Significant Influence and Control shall be defined as follows for the SBO Regulations: Significant influence is the ability to engage directly or indirectly in a reporting firm's financial and operating policy decisions, but not control or joint control. The control must include the right to pick a majority of the board of directors that controls management or policy choices, whether exercised directly or indirectly, including through ownership or management rights, shareholders agreements or voting agreements, or any other manner. Except for those connected to SI or control, a person or organization must exercise rights or entitlements indirectly, directly, or both indirectly. It is critical to recognize that this legislation also applies to SBOs. To be classified as an SBO, a person must indirectly exercise rights or privileges. Because the shares are held directly, a person who owns 15% of the Company's common stock is not considered an SBO. Significant Influence and Control are defined under the Act Significant Influence is defined as the ability to participate directly or indirectly in the reporting firm's financial and operational policy choices, but not to exercise control or joint control. A reporting corporation must comply with Section 90² of the Act. The ability of one or more individuals, acting alone or jointly, directly or indirectly, through shareholding or management rights, shareholders agreements, voting agreements, or any other means, to name a majority of directors or control management or

¹ Companies Act 2013 s 90(1)

² Companies Act 2013 s 90

policy decisions is defined in section 2(27) of the Act³. For example, firm A owns 70% of firm B, firm C owns 60% of firm A, and firm X owns 45% of firm C. Corporation X wields substantial authority and influence on business C in this case. As a result, while X may not possess a majority share in C, it may be perceived to have significant influence or control over C, and hence over the Reporting Company. As a result, he will be classified as an SBO, and a declaration will be required.

SBO EVOLUTION

The Financial Action Task Force, which was formed in 1989 to combat money laundering, terrorist financing, and other threats to the global financial system presented by financial crime, has developed broad recommendations on beneficial ownership. According to the FATF, beneficial ownership includes both the client's ultimate owner or controller and the natural person for whose benefit a transaction is carried out. It also includes the members of a legal body or agreement who make decisions. The MCA⁴ published the Companies (Significant Beneficial Owner) Amendment Regulations, 2019, on February 8, 2019, modifying the Companies (Significant Beneficial Owner) Rules, 2018.⁵ Section 90⁶ of the Companies Act of 2013 establishes a company's major beneficial owners' disclosure obligations. Section 90⁷ and the Regulations were made public in June 2018 by the Financial Action Task Force (FATF) guidelines to prevent money laundering and terrorist financing. The FATF has recommended states avoid using legal corporations to launder money or finance terrorists, and to ensure that authorized authorities have access to appropriate, accurate, and timely information on the beneficial ownership and management of legal enterprises.

³ Companies Act 2013, s 2(27)

⁴ Companies (Significant Beneficial Owners) Amendment Rules 2019

⁵ Companies (Significant Beneficial Owners) Rules 2018

⁶ Companies Act 2013 s 90

⁷ *Ibid*

UNDERSTANDING OF RIGHTS AND PRIVILEGES

If an individual or a group of individuals desires to gain SBO status, they must make use of the Act's rights and privileges, which can aid them in achieving SBO status. These are the perks or rights:

- An SBO is defined as a person or group that holds at least 10% of the company's outstanding shares. The proportion of shares owned by the SBO in the Reporting Company is derived based on the number of shares held by the SBO. For SBO purposes, shares include equity shares, global depository receipts, forced convertible preference shares, and CCDs (compelled convertible debt). It's worth noting that convertible instruments don't have to be converted into equity shares to contribute toward the 10% or more limit. There are further 10% or more restrictions on the total number of equity shares, CCPS, and CCD.
- They must own at least 10% of the voting power in the Reporting Company's shares, either directly or indirectly. Individuals who directly or indirectly own 10% or more of the voting rights in the Reporting Company's shares must be reported as SBOs in proportion to the number of voting rights they hold in the Reporting Company. Keeping in mind that neither CCPS nor CCD has voting rights, only equity voting rights will be considered for this purpose. Persons who own redeemable or convertible preference shares are not allowed to utilize their acquired voting rights.
- It has the right to receive or share in at least 10% of the total dividends or other payments that can be paid in a fiscal year, either directly or indirectly. Whoever receives or has the right to receive 10% of the Reporting Company's total distributable dividend based on holdings in the Reporting Company, either directly or indirectly, will be regarded as an SBO concerning the percentage of dividend rights held in the Reporting Company. Even though another distribution is not defined, it appears to correspond to the interests listed on CCD forms.
- It has the legal or actual authority to exert significant influence or control through means other than physical possession. Individuals or organizations with significant influence or

control over a Reporting Company solely via direct ownership are likewise considered SBOs. The term 'ownership' or control can apply to any arrangement or share ownership. Although owning at least 10% of a firm is already a requirement for SBO, SI or control must be proven by a written agreement or understanding.

AN SBO CAN EXERCISE RIGHTS AND ENTITLEMENTS DIRECTLY OR INDIRECTLY

Any person who owns or acquires a beneficial interest in the Reporting Company's shares and has filed a declaration under Section 89 of the Act is regarded to directly own a right or entitlement. Based on the legal structure of the member, the Revised Regulations specify the requirements for direct holding rights and entitlements in the Reporting Company. Here's a quick rundown:

1. Direct Entitlement: A person is considered to have a direct interest or entitlement in the Relevant Company if any of the following conditions are met: This individual owns or acquires a beneficial interest in the Relevant Company's shares by 89(2) of the Companies Act 2013 and has notified the Relevant Company of this fact.

2. Implied entitlement

Organization - A person is considered to have an indirect right or entitlement to the Relevant Company through a body corporate (other than a limited liability partnership) if the person:

(a) owns a majority stake in the body corporate; or

(b) owns a controlling interest in the body corporate's ultimate holding corporation.

HUF - If a person is the karta of a Hindu Undivided Family (HUF), that person is regarded to have an indirect interest or claim in the Relevant Company.

Partnership - If a person is a partner, owns a majority stake in the body corporate that is a partner, or owns a majority stake in the body corporate that serves as a partner's ultimate holding company, that person is considered to have an indirect right or entitlement in the relevant company through a partnership.

Trust - A person is assumed to have an indirect right or interest in the Relevant Business if they are

- (a) a trustee (in the case of a discretionary or charitable trust);
- (b) a beneficiary (in the case of a particular trust); or
- (c) the trust's author or settlor (in case of a revocable trust).

Pooled investment vehicles - It is believed that a general partner, investment manager, or chief executive officer of a pooled investment vehicle owns an indirect right or entitlement to the relevant business through the pooled investment vehicle or an entity under its control (where the investment manager is a body corporate or a partnership).

Nevertheless, this is only applicable if the company that manages a pooled investment vehicle is based in a FATF member country and its securities market regulator is a member of the International Organization of Securities Commissions. The criteria for businesses, HUFs, partnerships, and trusts will apply in all other circumstances.

According to the revised Rules, a major beneficial owner is a person who, acting alone, jointly, through one or more people, or a trust, holds any of the following rights or entitlements in the reporting company:

- possesses at least 10% of the company's shares directly, indirectly, or in conjunction with other holdings;
- holds at least 10% of the voting rights of the shares directly or indirectly.

Significant beneficial ownership must be disclosed: Each individual who is a major beneficial owner of the Relevant Company must submit a declaration on Form BEN-1 to the Relevant Company within ninety days of the Amendment Rules taking effect. Within 30 days of the acquisition or change, any individual who acquires or modifies a significant beneficial ownership stake in the Relevant Company must file a Form BEN-1 declaration to the Relevant Business. If a person acquires considerable beneficial ownership in the Relevant Company or

changes their principal beneficial ownership within that time, they must submit Form BEN-1 with the Relevant Company within 30 days of the conclusion of the aforementioned 90-day period.

Obligation Acceptance: All SBOs must submit a Form BEN-1 declaration to their relevant firm within 30 days of obtaining SBO status, according to the new Rules. Similarly, these SBOs must give the same report within ninety days of the new legislation going into effect. The adjustment went into effect on February 8, this year.

EXEMPTS FROM THE AMENDMENT

Under the new SBO Regulations, the following entities are exempt from reporting requirements:

- Investor Education and Protection Fund;
- The parent corporation of the reporting company;
- The federal, state, and regional governments;
- Organizations overseen solely by the federal government, by one or more state governments, or jointly by the federal and state governments;
- Securities and Exchange Board of India-approved investment instruments (SEBI);
- Investment vehicles are supervised by India's Pension Fund Regulatory and Development Authority, Insurance Regulatory and Development Authority, and Reserve Bank of India.

Penalties: SBOs that fail to file Form BEN-1 will be fined between INR 1,000,000 and INR 10,000,000 lakhs, plus INR 1,000 per day for each day of failure. Companies that fail to meet the various standards will be penalized between INR 1,000,000 and INR 500,000 (this includes the individuals in control), with persistent violations costing INR 1,000 per day.

CHANGES TO THE LAW BROUGHT FORTH BY THE REGULATIONS

Section 90⁸ of the Act in conjunction with the Companies (Significant Beneficial Owners) Regulations of 2018, specifies two criteria for determining whether a person qualifies as a reporting company's SBO:

- An objective test of 10% ownership in the reporting firm and majority ownership throughout the ownership chain;
- Control and considerable influence are defined in Section 2(27)⁹ of the Act and Rule 2(1)(i) of the SBO Regulations, respectively, as having the right to or exerting substantial influence or control via any way other than direct holding alone. A factual examination is required in every circumstance to establish if this subjective criterion is met within the unique factual matrix. The Corporations (Amendment) Act of 2019 significantly altered Section 90¹⁰ before the limits went into force. Section 90 proposes a legal piercing of the corporate veil to identify the reporting entity's SBOs. Section 90 applies extraterritorially to foreign trusts and non-Indian residents. As a result, its mission is broad and affects many parties.
- Section 89¹¹ first defined a beneficial interest for Sections 89 and 90.

The following rights and entitlements may apply to shares held by a person or organization, whether gained directly or indirectly through a contract, agreement, or another arrangement:

- Exercise or encourage the exercise of any or all of the share's rights.
- Participate in or receive dividends and other share-related payouts.

The SBO Rules were initially issued by the Ministry of Corporate Affairs (MCA) in 2018, however, they were not implemented due to interpretation concerns. The MCA has made major changes to the SBO Rules since then, which went into effect on February 8, 2019. The new

⁸ *Ibid*

⁹ Companies Act 2013 s2(27)

¹⁰ Companies Act 2013 s 90

¹¹ Companies Act 2013 s 89

deadline for submitting BEN-2 declarations (the MCA form necessary for reporting businesses to submit SBO statements) is December 31, 2019. This deadline has been extended several times. Sadly, despite the comprehensive rewriting of the SBO Rules that was previously published, identifying an SBO in a reporting firm is exceedingly difficult due to several interpretation issues in the SBO Rules. Even though the current SBO Rules are vastly improved over their predecessors, there is still some confusion around the determination of the SBO in some cases. We are aware that section 90(1) of the Companies Act of 2013 specifies a 25% criterion, whilst the revised Regulations of 2018 provide a 10% requirement. A Reporting Company must also: Send a Form BEN-2 report to the Registrar on any Substantial Beneficial Owner declarations and changes to Significant Beneficial Ownership. Maintain a Substantial Beneficial Owners record using Form BEN-3. Their names, addresses, birth dates, and ownership information must be included in the registration. Send a notification to all non-individual members who control more than 10% of the shares, demanding that they give information about that member's SBO (in Form BEN-4), and file a complaint with the National Company Law Tribunal to restrict the shares if the relevant information is not provided.

ANALYSIS

The Rules have shifted the idea of beneficial ownership away from relying solely on disclosure by concerned individual shareholders and toward requiring the firm to take the actions necessary to identify SBO. Identifying SBO may be difficult when individuals (even shareholder members) work together without the firm's knowledge, i.e. they have not made a particular disclosure of beneficial ownership/SBO. The Regulations do not specify any actions in this one-of-a-kind case, and it is unclear what methods the corporation would use to uncover SBO. If the parties are related, it is uncertain if their shares will need to be clubbed to qualify for SBO in the future. In this scenario, the exercise of enormous influence is critical for determining SBO.

The Guidelines do not define what constitutes involvement in financial and operational policy choices made by the organization:

- Reducing the threshold to 10% is an extra-statutory breach of the Act.

The simple language of Section 90(1)¹² of the Act implies that the Regulations made by the MCA [under the power conferred by Section 469¹³ of the Act]¹⁴ cannot decrease the beneficial interest threshold to less than 25%, and can only prescribe a level that is larger than 25%. Nevertheless, given Section 90(1) also includes the phrase 'other proportion as may be specified', the MCA may claim that a combined reading of Sections 90(1) and 469 provides its jurisdiction to decrease the threshold to 10%. Although both readings are feasible, it is useful to evaluate Section 90(1) in light of Supreme Court (the SC) principles on the delegation of legislative power. The Supreme Court declared in its well-known judgment in *Re: The Delhi Laws Act, 1912*, that the legislature must preserve its core legislative tasks, which include expressing legislative objectives and determining the standard to be enforced as a rule of law.

The Supreme Court held in *Rajnarain Singh v Chairman*¹⁵, Patna Administration Committee (commonly known as 'Rajnarain Singh'): 'According to the majority of opinions, an administrative authority may be authorized to change current or future law, but only in a minor fashion. What constitutes an important characteristic cannot be stated in broad words, and many viewpoints were expressed in the preceding instance, but one thing is evident from the aforementioned perspectives: it cannot contain a policy change.' The creation and expression of legislative policy is an "essential legislative role" that belongs to the legislature and cannot be transferred to the executive branch, according to the Supreme Court's judgments in *Re: The Delhi Laws Act, 1912*¹⁶ and *Raj Narain Singh v Chairman*. Given that Section 90(1) expressly states that the Parliament's policy is to have a not less than 25% threshold, it could be argued that the power to reduce the threshold to less than 25% can only be exercised by the Parliament and that such an "essential legislative function" cannot be delegated to the MCA.

As a result, it might be claimed that the 10% requirement outlined in the SBO Regulations exceeds the power granted by Section 90 of the Act and should be overturned in court. • Reduce the criterion to 10% by suggesting a reform to Section 90(1) of the Act; or • Change the SBO

¹² Companies Act 2013 s 90(1)

¹³ Companies Act 2013 s 469

¹⁴ Companies Act 2013, s 469

¹⁵ *Rajnarain Singh v Chairman* AIR (1954) SC 569

¹⁶ *Re: The Delhi Laws Act, 1912* AIR (1951) SC 332

Regulations and change the threshold to 25%, which is easier because it eliminates the need to approach Parliament.

- **Misuse is possible under Section 90(7)¹⁷**

Section 90(5)¹⁸ of the Act requires a firm to notify any individual it knows or has reasonable grounds to believe is an SBO of the company; knows the identity of an SBO or another person likely to have such knowledge; or was an SBO of the company at any time during the three years preceding the date of notification and is not listed as a significant beneficial owner. Within 15 days of the notice's expiration, the company must apply to the NCLT for an order requiring limits on interest transfers, suspension of all rights connected with the shares, and any other restrictions the court deems necessary. The corporation may also apply to the NCLT for an order directing that the shares in question be subject to limitations, such as limitations on the transfer of interests, suspension of dividend rights, suspension of voting rights, and any other restriction on all or a portion of the rights associated with the shares, according to Rule 7 of the SBO Rules.

The requirements of Section 90(7) of the Act are extremely vulnerable to abuse, particularly where there is a disagreement between majority and minority shareholders. In such cases, the majority shareholder may petition the NCLT under Section 90(7), claiming that the minority shareholder has not submitted an SBO declaration or that the information presented is insufficient. If the NCLT comes to the same decision, it might have serious ramifications for minority shareholders, since the NCLT could suspend their voting, dividend, and other rights.

Section 90(7) threatens Indian private equity investors that own a significant minority share in Indian enterprises. If the promoter and the PE investor disagree, the promoter may petition the NCLT to suspend the PE investor's voting, dividend, and other rights and transfer their shares to the Investor Education and Protection Fund if the PE investor's SBO representations were incorrect or lacking (IEPF).

¹⁷ Companies Act 2013, s 90(7)

¹⁸ Companies Act 2013, s 90(5)

- **Equity and Preferred Shares or Equity only**

Given the definition of beneficial interest in Sections 89(10)¹⁹ and 90, there are differing views on whether equity and preference shares, or only equity shares and convertible instruments, should be considered for SBO determination. According to one school of thinking, while defining the ownership requirement for recognizing the SBO, both equity and preference shares must be taken into account. Only equity shares, Global Depository Receipts, Cumulative Convertible Preference Shares, and Cumulative Convertible Debentures may be used to calculate the 10% criterion, according to Part VI of the SBO Rules.

According to the opposition, the holding of such Redeemable Preference Shares (RPS) must be evaluated using the definitions of the beneficial interest under section 89(10) and majority stake under Rule 2(1)(d)(iii) of the SBO Rules if the person has the right to receive or participate in more than fifty percent of the distributable dividend, including any dividend from RPS. The term "shares" is used in Sections 89 and 90 of the Act. The Supreme Court has ruled that rules enacted under parent legislation may be utilized to construe the parent statute (*Telco v Gram Panchayat, Pimpri*)²⁰.

- **Shares owned by a corporation-controlled discretionary private trust**

The SBO Guidelines are ambiguous on who should be identified as an SBO when shares are managed by a private irrevocable discretionary trust and the trustee is a corporate trustee. A private discretionary trust owns the stock of a business. There is still a lack of transparency when the shares are owned at the top of the ownership chain by a private discretionary trust with a corporate trustee. Because of the serious consequences of filing an "incorrect declaration," businesses have been hesitant to make SBO reports when all of the facts are unclear. There is concern about the consequences of SBO statements under the Income Tax Act of 1961²¹, the Money Laundering Prevention Act of 2002²², the Bankruptcy Code²³, and the Prohibition of

¹⁹ Companies Act 2013, s 89(10)

²⁰ *Telco v Gram Panchayat, Pimpri* (1976) AIR 2463

²¹ Income Tax Act 1961

²² Prevention of Money Laundering Act 2002

²³ Insolvency and Bankruptcy Code 2016

Benami Property Transactions Act of 1988²⁴. One of these repercussions of an allegedly "inaccurate declaration" might emerge from Section 90(7) of the Act." It is conceivable to argue that there is no SBO in this circumstance if one closely adheres to the Rules' explicit wording.

- **Shares of a Dead SBO whose share transfer has not been completed due to disagreements**

It is unclear who should file the SBO declaration when the beneficial owner has not yet been identified. This includes cases when the SBO has died and the shares he or she owned cannot be properly and economically transferred to his or her legal successors owing to a disagreement over the legitimacy of the will in a testamentary succession. It may also be used in cases of intestate succession if the court has not issued succession certificates or letters of administration. Section 247 of the Act of 1925²⁵ authorizes courts to appoint an administrator pendent lite in specific circumstances. This person serves as a court officer and temporarily holds the shares until the legality of the will is resolved.

- **The interplay of Section 90 and the Regulations with other laws**

It is unclear how SBO declarations interact with other laws and regulations, including the Income Tax Act, the Prohibition of Benami Transactions Act of 1988, the SEBI Regulations of 2018²⁶, the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations of 2011²⁷, the Black Money Act of 2015²⁸, and the Insolvency Act. There is also fear that submitting SBO disclosures may jeopardize the bankruptcy-remoteness of trust-held shares.

- **Implications of Non-Declaration or False Declaration**

Rule 2A of the SBO Regulations²⁹ requires the reporting company to discover if any individual is an SBO and, if so, to identify that individual and compel him to sign Form No. BEN-1. If a

²⁴ Prohibition of Benami Property Transactions Act 1988

²⁵ Indian Succession Act 1925, s 247

²⁶ Stock Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations 2018

²⁷ Stock Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations 2011

²⁸ Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act 2015

²⁹ Companies (Significant Beneficial Owners) Amendment Rules 2019, r 2A

member (other than a person) owns at least 10% of the company's shares or voting rights or has the right to receive or participate in a dividend or other distribution, the reporting entity must file Form No. BEN - 4. In the event of misdeclaration or non-declaration of SBO, the National Company Law Tribunal (NCLT) may issue an order preventing the transfer of shares in question, suspending all rights connected with such shares, etc. The whole ownership at issue may be transferred to an Investor Education and Protection Fund if the SBO fails to remove the order within one year.

CONCLUSION

The new Regulations have increased the regulatory burden by imposing additional significant beneficial ownership standards to restrict the use of multi-layered business entities for money laundering and tax evasion. Furthermore, they have raised the barriers and regulations of routine and lawful business transactions. In addition to doing due diligence, investors must ensure that all relevant parties have completed the necessary documentation and disclosures to avoid any future claims challenging the seller's capacity and/or permission to transfer the shares. Given that the legislation may occasionally be viewed subjectively, the proportion of ownership is not the only criterion for declaring an SBO. With the adoption of the SBO definition and its obligations under section 90, each share must now be recognized as a collection of rights (right to vote, right to receive dividends, and so on), and each right associated with a share is transferable. As a result, a single share may have several beneficial owners. This may necessitate a review of all current shareholder agreements, voting agreements, and so on to determine if the rights conferred by such arrangements have triggered filing obligations under sections 89 and 90 of the Act.