

## **IDENTIFICATION OF SIGNIFICANT BENEFICIAL OWNERSHIP IN INDIA**

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### **Abstract**

The below article analyzes the Companies (Significant Beneficial Owners) Amendment Rules, 2019 in the context of identifying individuals or a group of individuals who constitute significant beneficial owners in a company registered in India. The objective of the aforesaid rules is to prevent misuse of corporate vehicles in India, engage in money laundering or tax evasion related activities. This article shall explain how key managerial personnel in a company registered in India can identify individuals who constitute a “significant beneficial owner” in such companies and the process to be followed to ensure compliance with the requisite reporting requirements. The author is a corporate lawyer and is a graduate from Gujarat National Law University.

### **Genesis of the the Companies (Significant Beneficial Owners) Rules, 2018**

The concept of significant beneficial ownership was globally first promulgated by the Financial Action Task Force (“**FATF**”). The FATF is an independent inter-governmental body that develops and promotes policies to protect the global financial system from money laundering, terrorist financing and the financing of proliferation of weapons of mass destruction. The FATF published a guidance note<sup>2</sup> on “Transparenncy and Beneficial Ownership”, which primarily requested all member countries of the FATF, which India being one such member, to bring about domestic laws pursuant to FATF’s requirement of “Recommendation 24”, which fundamentally requires member countries to ensure that there is adequate, accurate and timely information available on the beneficial ownership of all legal persons, and that authorities from member

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<sup>2</sup> FATF, *Transparenncy and Beneficial Ownership* (October, 2014), <http://www.fatf-gafi.org/media/fatf/documents/reports/Guidance-transparency-beneficial-ownership.pdf>

countries can access this information in a timely manner<sup>3</sup>. Accordingly, pursuant to the Companies (Amendment) Act, 2017<sup>4</sup>, the Ministry of Corporate Affairs, Government of India (“MCA”) introduced Section 89(10) in the Companies Act, 2013<sup>5</sup> to add a new definition in the context of Recommendation 24 –

*For the purposes of this section and section 90, 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 -*

*(i) exercise or cause to be exercised any or all of the rights attached to such share; or*

*(ii) receive or participate in any dividend or other distribution in respect of such share.*

Hence, the legal framework to determine significant beneficial owners (“SBOs”) in legal persons in India is governed by Section 89(10) of the Companies Act, 2013 read with the Companies (Significant Beneficial Owners) Rules, 2018<sup>6</sup> (“SBO Rules”), a set of rules initially introduced by the MCA on June 13, 2018. However, the aforesaid 2018 rules were devoid of any timelines or clear rules for reporting companies in India to identify and register with the MCA SBOs. Consequently, on February 08, 2019, the MCA notified the the Companies (Significant Beneficial Owners) Amendment Rules, 2019<sup>7</sup> (“Amendment Rules”), which significant amended the SBO Rules to provide reporting companies clear tests to identify amongst their members, SBOs, and also provided detailed reporting forms to capture requisite information in this regard.

Essentially, the Amendment Rules placed the legal onus on reporting companies, namely companies and body corporates to whom the Companies Act, 2013 applies, and such reporting companies are required to enquire amongst its members to identify any individual or group of individuals who constitute an SBO within the purview of Section 89 of the Companies Act, 2013 read with the SBO Rules. On due identification of the relevant SBOs, members are required to intimate the same, in writing, to the reporting company within a stipulated timeline (as

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<sup>3</sup>FATF, *Interpretive Note to Recommendation 24*, paragraph 1

<sup>4</sup>Companies (Amendment) Act, 2017, No. 1, Acts of Parliament, 2018

<sup>5</sup>Companies Act, 2013, No. 18, Acts of Parliament, 2013

<sup>6</sup>Companies (Significant Beneficial Owners) Rules, 2018, MCA, June 13, 2018

<sup>7</sup>Companies (Significant Beneficial Owners) Amendment Rules, 2019, MCA, February 8, 2019

prescribed under the SBO Rules) and the reporting company subsequently notifies the MCA of such information.

### **How to identify an SBO?**

Pursuant to the clarity brought about by the Amendment Rules, the SBO Rules now contains the following two tests to help reporting companies identify and report on SBOs within:

1. Objective Test; and
2. Subjective Test.

Set out below are key provisions from the Companies Act, 2013 and the SBO Rules that constitute either of the above two tests.

#### Objective Test

First, Section 90(1) of the Companies Act, 2013, stipulates that – *“Every individual, who acting alone or together, or through one or more persons or trust, including a trust and persons resident outside India, holds beneficial interests, of not less than twenty-five per cent. or such other percentage as may be prescribed, in shares of a company or the right to exercise.....(herein referred to as “significant beneficial owner”), shall make a declaration to the company, specifying the nature of his interest and other particulars...”*<sup>8</sup>. However, the objective test to identify SBOs does not begin with twenty five percent shareholders in a reporting companies as the SBO Rules, as result of the phrase *“..twenty-five per cent. or such other percentage as may be prescribed..”* in Section 90(1) of the Companies Act, 2013, requires SBOs to be primarily identified using the below key definition in Rule 2(1)(h) of the SBO Rules<sup>9</sup>:

*“significant beneficial owner” in relation to a reporting company **means an individual referred to in sub-section (1) of section 90**, who acting alone or together, or through one or more persons or trust, possesses one or more of the following rights or entitlements in such reporting company, namely:-*

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<sup>8</sup>Section 90(1), Companies Act, 2013, No. 18, Acts of Parliament, 2013

<sup>9</sup>Rule 2(1)(h), Companies (Significant Beneficial Owners) Rules, 2018, MCA, June 13, 2018

- (i) **holds** indirectly, or together with any direct holdings, **not less than ten per cent. of the shares**;
- (ii) **holds** indirectly, or together with any direct holdings, **not less than ten per cent. of the voting rights in the shares**;
- (iii) **has right to receive or participate in not less than ten per cent. of the total distributable dividend**, or any other distribution, in a financial year through indirect holdings alone, or together with any direct holdings;

[EMPHASIS ADDED]

Therefore, any individual, be it in India or overseas who directly or indirectly holds ten percent or more or either shares, voting rights in the shares or participate in dividend distribution in the above manner, will be considered an SBO. To enable assessing of indirect holdings, the Amendment Rules prescribe the following “*Explanations*” to Rule 2(1)(h) of the SBO Rules:

1. Explanation I – if an individual does not fulfil any of the conditions under sub-clauses (i) to (iii) of Rule 2(1)(h) of the SBO Rules, then such individual shall not constitute an SBO;
2. Explanation II – identifies individuals who have direct holdings in the reporting company;
3. Explanation III – helps indentify individuals who hold majority stake (*same definition as per the definition of control in the Companies Act, 2013*) in the member of the reporting company or the ultimate holding company of the member; and
4. Explanation IV – helps identify SBOs in members who are entities controlled by pooled investment vehicles that are based in jurisdictions that are not member states of the FATF and are not members of the International Organization of Securities Commission.

It should be noted that pursuant to the above provisions of Rule 2(1)(h), reporting companies send notices to their members in Form BEN-4 under the SBO Rules, and the members are required to respond to such Form BEN-4 notice within thirty days of receipt of such notice, in Form BEN-1.

#### Subjective Test

Apart from direct holdings alone, any individual having the right to exercise “significant influence” or control in the reporting company will constitute an SBO. Explanation VI under Rule 2(1)(h) defines “significant influence” to mean – *“the power to participate, directly or indirectly, in the financial and operating policy decisions of the reporting company but is not control or joint control of those policies.”*

Essentially, the subject test focuses on individuals, like directors on the board of a reporting company that participate in decision making of the day-to-day activities of a particular company, but fall one bar short of actually controlling such a company. Individuals who are identified as SBOs under the subjective test are also required to submit written agreements in Form BEN-1 to the reporting company, which captures the nature of the significant influence that they exercise.

### **Interplays with Other Laws**

Members of reporting companies must also keep in mind the following statutes while making a declaration under Form BEN-1 to the reporting company:

1. definition of “benami” under the Prohibition of Benami Transactions Act, 1988;
2. definition of “ultimate beneficial owner” under the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018; and
3. definition of “beneficial owner” under the Income Tax Act, 1961.