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Analysing developments impacting business

MCA Notifies Rules for Disclosure of Ultimate Beneficial Ownership of Companies

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The concept that companies are independent corporate personalities and have separate juristic nature has been often misused for illicit purposes, including money laundering and other illegal activities. To bring transparency to the manner in which shares of companies are held, and in compliance of India's obligations to align its regulatory framework with the recommendations of Financial Action Task Force, an intergovernmental organization constituted to formulate policies to combat money laundering and terror financing, the Ministry of Corporate Affairs (MCA) notified on 13 June 2018 (i) Section 90 of the Companies Act, 2013 (Act); and (ii) the Companies (Significant Beneficial Owners) Rules, 2018 (SBO Rules). These prescribe detailed requirements for identifying the individuals who hold 'ultimate' control over a company.

Section 90 of the Act

Disclosure Requirements - Paradigm Shift under Corporate Law!

Section 90 of the Act requires every individual who, either by himself or with others (including a trust and persons resident outside India), qualifies as a significant beneficial owner (SBO) of a company to make a declaration to that company specifying the nature of his beneficial interest. As per Section 90 of the Act, an SBO is an individual who, either by himself or with others, directly or indirectly through persons (resident or non-resident) including trusts holds beneficial interests of at least 10% (the threshold of 25% prescribed under the Act has been lowered to 10% under the SBO Rules), in shares of a company or has the right to exercise significant influence or control (defined in Section 2(27) of the Act) over a company.

Additionally, Section 90 of the Act requires every company to do, *inter alia*, the following:

- (i) maintain a register of the interest declared by individuals along with the prescribed particulars of such individuals and keep the register open for inspection by shareholders;
- (ii) file a return of SBOs of the company with the Registrar, containing the prescribed particulars;

- (iii) give notice to any person whom the company believes to be a SBO of the company or to have been a SBO of the company during the preceding three years and who is not registered as a SBO; and
- (iv) if a person fails to provide the information sought by a company, the company is required to apply to the National Company Law Tribunal (NCLT) for an order directing that the shares in question be subject to prescribed restrictions including those with respect to transfer of shares and suspension of rights attached to the shares, amongst others.

SBO Rules

The SBO Rules significantly expand the definition of SBO as provided in Section 90 of the Act.

Who qualifies as an SBO as per the SBO Rules?

- (i) an individual holding ultimate beneficial interest (as defined in Section 89 (10) of the Act) of not less than 10% in a company but whose name is not entered in the register of members of a company as the holder of such shares;
- (ii) in case where the shareholder is a company or a partnership firm, the SBO is the natural person who, whether acting alone or together with others, holds not less than 10% of the share capital of the company or is entitled to 10% of the profits of the partnership firm or who exercises significant influence or control in the company or partnership firm through other means;
- (iii) for a trust (acting through its trustee), the SBO shall include the settlor, trustee or beneficiaries of the trust with not less than 10% interest in the trust and other persons exercising effective control over the trust; and
- (iv) where no natural person is identifiable in case the member is a partnership firm or a company, the SBO would be the relevant natural person who holds the position of senior managing official.

Other key requirements prescribed in the SBO Rules are:

- (i) every SBO is required to file within the prescribed timelines a declaration in Form No. BEN-1 to the company in which he holds the SBO;
- (ii) once any declaration is received by a company, the company is, in turn, required to file a return in Form No. BEN-2 with the Registrar in respect of such declaration;
- (iii) each company is required to maintain a register of SBOs which shall be available for inspection to shareholders;
- (iv) in case the information is not provided to the company or where the information provided is unsatisfactory, the company may apply to the NCLT for directing restrictions on the shares. The restrictions sought could be prohibition on transfer of subject shares, suspension of voting rights or other prescribed rights; and
- (v) Mutual Funds, Alternative Investment Funds, Real Estate Investment Trusts and Infrastructure, Investment Trusts, which are regulated under the Securities and Exchange Board of India Act, 1999, are exempt from this requirement.

Section 89 of the Act

Section 89 of the Act requires a person, whose name is entered in the register of members of a company as a shareholder but who doesn't hold beneficial interest in such shares as well as the owner of any beneficial interest, to make a declaration to the company specifying the name and other details of the persons who are registered holders and who hold such beneficial interest. Non-compliance of such disclosure obligations can be fatal to the enforceability of any rights attached to such shares in addition to other penal consequences.

Definition of 'Beneficial Interest':

As per the newly notified Section 89(10) of the Act, beneficial interest in the shares of a company includes, directly or indirectly, through contract or otherwise, the right of a person to exercise rights attached to such shares or receive or participate in any dividends or other distribution in respect of the shares.

How does this affect you?

For Companies:

The notification of Section 89 (10) and Section 90 of the Act and the SBO Rules significantly increases the onus on companies to identify and maintain adequate records of and update the Registrar with the details of SBOs. In doing so, companies will not only have to identify shareholders who hold, individually or with others, more than 10% shares of a company, but also those who directly or indirectly exercise control or significant influence in a company. Further, each company is required to give notice to any person whom the company knows or has reason to believe is an SBO or to have been an SBO during the preceding three years and who is not registered as such with the company. Where the information provided upon such notice is not satisfactory, the company is required to apply to the NCLT within a period of 15 days from the expiry of the notice for an order with directions to impose the above restrictions on such shares. Failure to comply with this requirement would attract prescribed monetary penalties.

For Shareholders:

The primary obligation of disclosure of significant beneficial interest has been cast on all natural persons who hold such interest directly and indirectly, regardless of their domicile or residency status.

Natural persons who, either directly or along with others (including through intermediate holding companies or trusts), hold 10% or more shareholding of a company, or who exercise 'significant influence' or 'control' in a company, are required to make a declaration of the nature of their interests to the company together with particulars of instruments embodying the transfer or acquisition of beneficial interest. Failure to comply with this requirement or suppression of any material information would attract both monetary and penal consequences.

Comment

The notification of Section 90 of the Act and the SBO Rules demonstrates the resolve of the Government of India to prevent the misuse of corporate vehicles by bringing in transparency regarding both the legal and beneficial owners (natural persons who are significant beneficial owners), the source of the corporate's assets, and its activities. This would allow the authorities to "follow the money" in financial investigations involving suspect accounts/assets held by corporates. However, neither the Act, nor the SBO Rules prescribe any bright-line tests for identification of 'significant influence'

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and this will pose some challenges in complying with the requirements by shareholders and companies. To determine the natural persons who hold 'ultimate' control over companies, the SBO Rules have prescribed piercing through the veil of non-individual shareholders. The term 'beneficial interest' has now been defined under Section 89 of the Act and recognises that the rights attached to the shares of a company are separable and assignable.

As India Inc adapts to this new disclosure regime, the writing on the wall is clear -- this is the anvil of a new era of transparency in the manner in which shareholding of companies is held and the *corporate veil* is no longer sacrosanct.

- Sharad Abhyankar (Partner), Anuj Shah (Partner) and Virja Dange (Associate)

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