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SIGNIFICANT BENEFICIAL OWNERSHIP- AN ANALYSIS UNDER INDIAN AND ENGLISH CORPORATE LAWS

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1 INTRODUCTION.

1.1 With a view to promote corporate transparency and prevent misuse of corporate vehicles for illicit purposes such as corruption, tax evasion, money laundering, the Financial Action Task Force ("FATF"), an international inter-governmental body established by the ministers of the member jurisdiction, has developed a series of recommendations on transparency and beneficial ownership of legal persons and arrangements. These recommendations require countries to ensure that adequate, accurate and timely information on beneficial ownership of corporate vehicles is available and assessable by competent authorities.

1.2 In view thereof, various member countries (including India and the United Kingdom) have either proposed or already brought about legislative measures on beneficial ownership. This article aims at providing a brief overview of the legislative changes that have been proposed or implemented by India and the United Kingdom in their respective corporate laws to bring about increased transparency on beneficial ownership of corporate vehicles.

2 CONCEPT OF 'SIGNIFICANT BENEFICIAL OWNER' UNDER INDIAN CORPORATE LAWS.

2.1. Existing position under Companies Act, 2013:

The Companies Act, 2013 ("CA 13"), recognizes the concept of beneficial interest in a share of the company. Declarations of beneficial interest in a share are to be given by both the legal owner and the

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person holding beneficial interest under Section 89 of CA 13. The company is required to record this information in its register and file requisite return with the Registrar of Companies within a prescribed time period. However, CA 13 does not define term '*beneficial interest in a share*'. Typically, such declarations are received by the company, in cases of wholly owned subsidiaries where a nominal number of shares are held by a nominee of the parent company to satisfy the legal requirement of having a minimum of two shareholders.

CA 13, however, does not provide a mechanism to identify the 'significant beneficial owners' of a company. It, therefore, fails to bring about transparency in corporate ownership, which in turn makes it difficult for regulatory authorities to identify and verify the identity of the individuals who ultimately own and control a corporate vehicle.

2.2. Proposed Development - Introduction of Concept of 'Significant Beneficial Owner':

To address the existing lacunae in CA 13, the concept of '*significant beneficial owner*' is now sought to be introduced in CA 13 by the Companies (Amendment) Bill, 2016 ("**Bill**"). The Bill, is however, pending approval of the Indian Parliament.

Key provisions of the Bill on significant beneficial ownership, are discussed as under:

- a. **Definition of 'Significant Beneficial Owner':** '*Significant Beneficial Owner*' has been defined to refer to "*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, or the actual exercising of significant influence or control as defined in clause (27) of section 2, over the company*".

The meaning of the expression 'significant influence', under Section 2(6) of CA 13 is also sought to be expanded to mean "*control of at least twenty per cent of total voting power, or control of or participation in business decisions under an agreement*". Under the existing Section 2(6), the meaning of 'significant influence' is linked to control of 20% of the share capital or business decisions under an agreement.

The term 'beneficial interest in a share' has also been defined, to include "*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) to receive or participate in any dividend or other distribution in respect of such share.*"

Interestingly, the central government has also been empowered to prescribe class/classes of person who may not be required to make the aforesaid declarations.



- b. Submission of Declarations: A declaration is required to be given to the company by every 'significant beneficial owner', specifying the nature of his interest and other particulars in the manner and time as may be prescribed.
- c. Register of significant beneficial owners and filing of returns: A company is required to maintain (and keep available for inspection by any member) a register of significant beneficial owners. A company is also required to file appropriate return on the beneficial owners with the registrar.
- d. Notice by Company. A company is also required to give notice to any person (whether or not a member of the company) whom the company knows or has reasonable cause to believe to:
 - i. be a significant beneficial owner of the company;
 - ii. have knowledge of the identity of a significant beneficial owner or another person likely to have such knowledge; or
 - iii. have been a significant beneficial owner of the company at any time during the immediately preceding three (3) years of the notice,

and who is not registered as a significant beneficial owner with the company.

The information required by the notice under sub-section (5) is to be given within a period not exceeding 30 days from the notice date.

- e. Consequences of non-compliance with the notice. Upon failure of the person to either furnish the required information in the notice or upon giving unsatisfactory information, the company is to apply to the National Company Law Tribunal within a period of fifteen (15) days, for an order directing that the concerned shares be subject to restrictions with regard to *inter alia* transfer of interest, suspension of rights attached to shares and such other prescribed matters.
- f. Failure to furnish declarations; returns etc. Any person who fails to furnish the required declaration of significant beneficial ownership is punishable with fine. Similarly, a company which fails to maintain the register of significant beneficial owners or denies its inspection, or fails to file the return, then such company and every officer of the company in default is also punishable with fine.

Further, any person wilfully furnishing false or incorrect information or otherwise suppresses material information in the declaration would also be liable for fraud under Section 447 of the CA 2013.

- g. Investigation into beneficial ownership of a company. The Bill also seeks to amend Section 216 of CA 13 (which deals with investigation of ownership of a company by inspectors appointed by the

Government), to include within its ambit investigation for determining persons who are or have been beneficial owners or significant beneficial owners of the company.

2.3. Existing Position under other legislations.

The issue of identification and reporting of 'beneficial ownership' is also dealt with under the extant Prevention of Money Laundering Act 2002, and the rules issued thereunder (collectively "**PMLA**"). PMLA requires banks, financial institutions and intermediaries (i.e. reporting entity) to identify the beneficial owner of its clients as prescribed and maintain record of documents evidencing identity etc. of such clients and their beneficial owners. 'Beneficial owner' has been defined as "*an individual who ultimately owns or controls a client of a reporting entity or the person on whose behalf a transaction is being conducted and includes a person who exercises ultimate effective control over a juridical person*".

Determination of beneficial owner under PMLA is linked to certain thresholds which vary depending on the legal nature of the client. For instance, 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 an ownership interest of more than 25% of share capital or profits or who exercises control through other means. Where the client is a partnership firm, the threshold of ownership/entitlement has been specified as more than 15% of capital or profits of the partnership.

On similar lines, the Securities and Exchange Board of India ("**SEBI**") also requires all registered intermediaries to obtain (as part of their client due diligence policy) sufficient information from their clients in order to identify and verify the beneficial owner of the client.

3 ANALYSIS UNDER ENGLISH LAW - CONCEPT OF 'PERSON WITH SIGNIFICANT CONTROL (PSC)'

The relevant English law provisions came into effect on 6 April 2016 under the Small Business, Enterprise and Employment Act 2015.

3.1 What is the PSC Register?

UK companies, Societates Europaeae (SEs) and limited liability partnerships (LLPs) (collectively referred to in this article as "**corporate entities**") will be required to identify and record those who own or control the corporate entity. All corporate entities are required to keep a Persons of Significant Control ("**PSC**") register, in addition to existing statutory registers such as the register of directors and register of members (shareholders), and must file PSC information with the central public register at Companies House.

3.2 Who is a PSC?

A PSC is an individual who meets one or more of the following specified conditions:

- I. An individual who holds more than 25% of the shares in the corporate entity.
- II. An individual who holds more than 25% of the voting rights in the corporate entity.
- III. An individual who holds the right to appoint or remove the majority of the board of directors of the corporate entity.
- IV. An individual who has the right to exercise, or actually exercises, significant influence or control over the corporate entity (where this does not fall into categories I to III above).
- V. Where a trust or firm would satisfy one of the first four conditions if it were an individual, any individual holding the right to exercise, or actually exercising, significant influence or control over the activities of that trust or firm.

The specified conditions above may be met directly or indirectly. A condition is met indirectly where an individual holds his/her rights through, for example, another corporate entity. These conditions may also be met under a number of less typical circumstances. For example, where there are agreements to vote or exercise rights jointly and the total combined value of the shares or rights exceed 25%.

If a corporate entity does not immediately know the identity of a PSC, it must take reasonable steps to identify such persons for the purposes of the PSC register. If a person refuses to provide the information they will commit a criminal offence. A corporate entity may also approach people (via service of a notice) who it believes has knowledge of who its PSCs are. Failure to comply with such approaches is also a criminal offence.

3.3 Relevant Legal Entities (RLE).

While principally aimed at recording the details of individual PSCs, Part 21A of the Companies Act 2006 also requires corporate entities to record the particulars of certain legal entities in their PSC register. To be capable of registration as a relevant legal entity (“**RLE**”) in relation to a corporate entity, the RLE must satisfy all of the following conditions:

- It must be a legal entity for the purposes of the PSC regime (i.e. it is a body corporate or a firm that is a legal person under the law by which it is governed);
- It would meet one or more of the specified conditions in paragraph 3.2 above if it was an individual;
- It must be subject to its own disclosure requirements (namely, that it is itself required to keep a PSC register or is a legal entity with voting shares admitted to trading either on a regulated market in a European Economic Area (EEA) state (other than the United Kingdom) or on any of the specified Israeli, Japanese, Swiss or US markets).

3.4 What information needs to be provided?

Before a PSC can be entered on the register, a corporate entity must confirm the details with the PSC by serving a notice on them. The details required are:

- name;
- date of birth;
- nationality;
- country where the PSC usually lives;
- service address;
- usual residential address (this information is not disclosed when the corporate entity makes its register available for inspection or provides copies of the PSC register, unless the register is held electronically at Companies House);
- the date he or she became a PSC in relation to the corporate entity (for corporate entities already in existence as at 6th April 2016, then 6th April 2016 should be used);
- which conditions for being a PSC are met: this must include the level of the relevant person's shareholding and voting rights, within the following categories:
 - Over 25% up to (and including) 50%,
 - More than 50% but less than 75%,
 - 75% or more.

It should be noted that a corporate entity's PSC register cannot be blank and a prescribed statement must be made either with the information above; to the effect that the corporate entity has no PSC's/RLE's; that the corporate entity believes there is a PSC/RLE and is investigating; or that a notice has been issued.

3.5 Updating the information.

Information on the corporate entity's own PSC register must be kept up to date. The corporate entity must enter updated information on its own PSC register if it has:

- become aware of a change;
- the information needed to be entered on its own PSC register becomes available; and
- had the information set out in paragraph 3.4 above confirmed by a PSC which had not been known or confirmed previously,

and provide updated information to Companies House as part of the Confirmation Statement (formally known as the Annual Return).

3.6 What happens if the requirements are not met?

Failure to comply with the requirements of the PSC regime, provide accurate information on the PSC register and failure to comply with notices requiring someone to provide information are criminal offences, and may result in a fine and or a prison sentence of up to two years. Where a PSC fails to comply with the various notices issued, the corporate entity has the ability to place restrictions on the shares or voting rights of a person or entity withholding information.

4 CONCLUDING REMARKS.

Under English law, the aim of the PSC register is to increase transparency over who owns and controls corporate entities in England and informing investors when they are considering investing in a corporate entity. It will also support law enforcement agencies in money laundering investigations.

In a similar vein, the 'significant beneficial ownership' related provisions in the Bill are expected to render corporate structures more transparent in terms of ownership and control. This would allow regulatory authorities and financial institutions ready and easy access to information about actual owners of the company, achieving the overall aim of preventing misuse of these corporate vehicles.

As the above illustrates, the provisions proposed in the Bill are quite similar to the position under English law. However, there are a few differences of note. For instance, the position under English law includes the possibility of prison sentences being imposed for; failure to comply with the requirements of the PSC regime, failure to provide accurate information and also on PSC's for failure to comply with notices requiring the provision of information. The Bill, however, only provides for imprisonment as a consequence of fraud in case of provision of inaccurate information or suppression of material information.

Also, the Bill does not provide for a concept of relevant legal entities (RLE) as contained under English laws. That said, as the Bill does require a declaration to be made by an individual qualifying as a 'significant beneficial owner', directly and indirectly through one or more persons (i.e. including through corporate entities), the appropriate information of the corporate structure/entity through which an individual may constitute a 'significant beneficial owner' is likely to be required to be disclosed in the declaration forms. The nature and extent of such required information would, however, become clearer once the relevant form(s) for making the requisite declaration are prescribed.

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