

Section 89 & 90 : Understanding the Spirit

Assessing beneficial ownership is akin to searching for a specific needle within a stack of identical needles. Attempting to delve deep into the concept of “Disclosure of Beneficial Ownership,” which requires companies to publicly declare the true owner if a nominal owner exists. Beneficial ownership occurs when influential individuals or those in the public eye, instead of openly acknowledging themselves as the owners of the companies from which they derive profits, designate someone else as the nominal owner. This practice makes it challenging for authorities to identify the actual owner, allowing them to conceal their income and, in turn, evade taxes.



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INTRODUCTION

Assessing beneficial ownership is akin to searching for a specific needle within a stack of identical needles. This article delves into the concept of “Disclosure of Beneficial Ownership,” which requires companies to publicly declare the true owner if a nominal owner exists. Beneficial ownership occurs when influential individuals or those in the public eye, instead of openly acknowledging themselves as the owners of the companies from which they derive profits, designate someone else as the nominal owner. This practice makes it challenging for authorities to identify the actual owner, allowing them to conceal their income and, in turn, evade taxes.

Beneath its facade, beneficial ownership conceals an underlying malevolence. The money saved is funnelled into the pockets of the wealthy, making them richer and financing various societal ills such as money laundering, corruption, bribery, terrorist financing, and various other illegal activities involving one or more companies. Any information about the beneficial owners serves to prevent these societal wrongs from occurring and, if already in progress, helps to control them. Therefore, possessing information on beneficial ownership is of utmost importance.

The significance of this lesson was underscored by the 2016 Panama Papers leak scandal, which exposed the identities of numerous affluent and prominent individuals who utilized offshore companies for illicit purposes, sparking public outrage. Access to information on beneficial

ownership has now become a crucial requirement for international tax transparency and the fight against tax evasion and other financial crimes.

WHAT IS BENEFICIAL OWNERSHIP?

Beneficial ownership is the situation where a person enjoys the advantages of owning a company, fund, trust, etc., while the legal ownership title is held by someone else. This practice has been employed by celebrities and powerful individuals to safeguard their assets, shielding them from inclusion in their calculated net worth or taxable income, thereby increasing their financial gains.

Typically, beneficial owners strive to remain anonymous. This anonymity provides cover for a multitude of criminal activities that can occur beyond the scrutiny of law enforcement agencies, including tax evasion, corruption, money laundering, and terrorist financing. For example, money laundering may involve complex transactions that legitimize funds from illegal sources, such as drug trafficking or tax evasion, making them appear legal. An example would be a drug trafficker establishing a nightclub to launder proceeds from drug sales under the guise of ticket and alcohol sales, appearing legal on the surface. Therefore, it is essential to identify beneficial owners of various legal entities and structures to prevent misuse in a business context.

This is why entities like the Financial Action Task Force (FATF) and the Global Forum have incorporated criteria for beneficial ownership in their guidelines and conducted cross-jurisdictional assessments of the availability of beneficial ownership information within their systems. Determining how countries access information on beneficial ownership for various legal entities and structures is crucial in the battle against tax evasion, corruption, money laundering and terrorist financing. Not everyone desires to be recognized as the beneficial owner.

Many wrongdoers deliberately exploit the anonymity provided by corporate entities to obscure their identity, the true nature of accounts, and the source or use of funds or assets associated with these entities. This can be for classic tax evasion purposes or to evade authorities tracking the proceeds of individual or corporate crimes, such as money laundering, bribery or corruption. It can also serve to conceal state-sponsored terrorist activities.

HISTORICAL CONTEXT OF BENEFICIAL OWNERSHIP

Beneficial ownership, as previously mentioned, occurs when an individual possesses and directly enjoys the advantages of a particular company, even though, on official documents, they are listed as a nominal or dummy owner. The Panama Papers scandal triggered significant public discontent with this practice, prompting the Indian government to introduce measures requiring beneficial owners to reveal their true identities.

India was not the sole nation to respond to this issue; other countries also implemented various measures to uncover beneficial owners because it is a concealed malevolence that needs to be eradicated from society. For instance, certain tax havens notify the United States when their citizens establish shell companies within their jurisdictions, aiding in the regulation of their citizens' financial activities.

Beneficial ownership provides a practical and secure method of holding shares, especially for investors seeking ownership of securities without the responsibility of voting or involvement in corporate affairs.

THE COMPANIES (SIGNIFICANT BENEFICIAL OWNER) AMENDMENT RULES, 2019 AND WHAT IT MEANS

In response to scandals like the Panama Papers, the Indian government took necessary actions to prevent such occurrences and combat black money. They aimed to gather comprehensive information for investigations and joined global efforts to address tax evasion. The Base Erosion and Profit Shifting (BEPS) initiative enables India to track tax avoidance by offshore tax havens. In 2017, the Companies (Amendment) Act replaced provisions related to Significant Beneficial Owners in the Companies Act. The Ministry of Corporate Affairs introduced the Companies (Significant Beneficial Owners) Rules in 2018, which mandates:

- Individuals with a significant shareholding or substantial influence in a company must declare their interest.
- This rule applies to individuals acting independently or in concert, trusts, and persons residing in India or abroad.
- “Significant Influence” means owning at least 20 percent of voting power or involvement in business decisions in related companies.
- “Control” encompasses the ability to appoint directors or influence management decisions.

These declarations must be made within 90 days of the law's implementation or within 30 days of a change in beneficial ownership. Companies must maintain a registry of significant beneficial owners and file relevant information with the Registrar.

In 2019, the Ministry of Corporate Affairs issued an amendment to the Companies Act, enforcing the rules related to “Significant Beneficial Owners.”

THE IMPLICATIONS THE ACT ON EXISTING TRANSACTIONS

The introduction of the “beneficial interest” concept in the Act has far-reaching consequences for existing transactions. Shares must now be viewed as a bundle of rights (voting, earning dividends, etc.), with each of these rights potentially allocated to different individuals. As a result, a single share can have multiple beneficial owners, necessitating a review of current shareholder agreements and voting arrangements to ascertain if they trigger filing requirements under Section 89 of the Act. Compliance with Significant Beneficial Owner (SBO) filings also becomes essential.

Key considerations include:

Structural Impact: The Act's transparency requirements may impact existing opaque structures. While the law prohibits sharing information with tax authorities, public access to SBO forms could raise concerns. This transparency may enable tax authorities to question the legitimacy of certain structures.

Due Diligence: Determining ownership becomes more complex due to the possibility of multiple beneficial interest holders. Diligence checks need to confirm the proper submission of declarations for all beneficial interests related to the share and verify the accuracy of SBO filings. Diligence checklists will also include a review of the SBO registry and related filings.

Documentation: Ownership representations should accurately reflect the “beneficial interest” concept to protect all aspects. Additionally, in cases with multiple beneficial interest holders, practical issues may arise during transfers, such as handling compensation and reporting under Exchange Control Regulations when non-residents own only a portion of the beneficial interest. Transaction documents should detail the scope of information to be recorded in SBO filings, and these reports should be included in post-closing transaction records.

Voting Arrangements: Voting arrangements may affect the creation of beneficial interests. The crucial distinction lies in whether the right generating interest is attached to the share or a mere contractual obligation. For instance, if shareholder A has the right to direct/exercise voting rights attached to shares held by shareholder B, A would be considered a beneficial interest holder in B's shares. Notably, veto rights or mere enabling provisions, like further assurances clauses, are less likely to establish beneficial interests, as they pertain more to contractual obligations rather than the creation of specific rights or concessions in favor of one shareholder. Veto rights typically grant blocking power but don't compel other shareholders to vote in a specific manner.

CHALLENGES TO THE ACTIONS TAKEN BY AUTHORITIES

Defining beneficial ownership introduces complexities, leading to downstream challenges. For instance, account names may differ from the actual beneficial owners, necessitating separate recording and storage of this data. Claims managers insist on merging cases with the same beneficial owner, which appears logical but can complicate case processing and payouts. When a case is valid, a single payment must be divided among multiple merged accounts.

However, Cyril Amarchand Mangaldas, an Indian law firm, has identified gray areas in the bill's applicability. Specifically, the rules do not address multi-layered hybrid structures with a company as the direct member and a trust as the ultimate holding entity. Moreover, the rules lack guidance on determining a significant beneficial owner when a discretionary trust has a non-individual trustee, creating uncertainties, especially for structures involving professional trustees or private trustee companies.

WHY DISCLOSURE OF BENEFICIAL OWNERSHIP MATTERS?

Public trust in organizations and markets hinges on an effective disclosure system that ensures transparency in the ownership and control structures of firms. Investor confidence in capital markets depends on the accurate disclosure of ownership and control structures, as well as the ultimate beneficial owner of publicly traded companies.

While significant investors with voting rights can promote long-term growth and firm success, there is a risk that controlling beneficial owners with substantial voting power may divert corporate assets and exploit opportunities for personal gain at the expense of minority investors.

Protecting these minority investors and ensuring equitable capital distribution is a vital concern in capital market regulation. The regulation aims to provide clarity on a company's substantial ownership, reveal the investment influence of major shareholders, and safeguard the rights of issuers and the public in the securities process.

In recent years, there has been a substantial increase in the need for beneficial ownership information, particularly to address anti-corruption legislation. Companies must now identify third-party intermediaries and contractors that may involve foreign government officials, as their involvement can raise concerns about bribery charges. Disclosure of beneficial ownership is crucial for transparency and compliance with regulatory requirements.

GLOBAL AUTHORITIES ON THE CASE

The Financial Action Task Force (FATF), an international organization responsible for guiding anti-money laundering and counter-terrorism financing efforts, is

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advising countries on beneficial ownership and urging Financial Institutions (FIs) to adopt a risk-based approach to customer interactions.

The FATF Recommendation outlines steps to address the transparency and beneficial ownership of legal entities, providing countries with suggestions to prevent the misuse of legal entities for illicit purposes. These recommendations include:

- Assessing potential risks associated with legal entities and legal arrangements.
- Ensuring transparency in legal entities and legal arrangements.
- Providing accurate and up-to-date essential and beneficial ownership information to competent authorities promptly.

These efforts signify a move toward accountability and the establishment of public records on the ultimate beneficial ownership of companies and institutions. However, enforcing these measures is challenging. Maintaining beneficial ownership data while dealing with increasingly complex global organizational systems is one of the major hurdles for FIs. Many challenges are related to data, including issues with data quality and data timeliness. Additionally, different countries have varying laws, and some places, like offshore tax havens, have obstacles in place to hinder the collection of beneficial ownership data, which criminals are quick to exploit.

EXEMPTIONS TO THE RULE

The rule does not require the disclosure of beneficial ownership for the following:

1. Shares held by Investor Education and Protection Fund;
2. Shares held by Holding reporting company;
3. Government Authority;
4. Mutual Funds;
5. Alternative Investment Funds (AIFs);
6. Real Estate Investment Trusts (REITs) and Infrastructure Investment Trusts (InvITs);
7. Investment vehicles regulated by RBI.

IDENTIFICATION OF BENEFICIAL OWNERS

Nature of shareholder	Who is the significant beneficial owner
Where a member is a company	<ul style="list-style-type: none"> An individual who in his capacity or jointly with other individuals or through one or more persons or trust holds 10 percent or more of the share capital of the company; or Exercise significant influence or control through other means; If no natural person is identified, the person holding the position of senior managing official will be considered.
Where a member is a partnership firm	<ul style="list-style-type: none"> An individual, who in his capacity or jointly with other individuals or trusts hold 10 percent or more of capital; or Has entitlement of not less than 10 percent of profits of the partnerships; If no natural person is identified, the person holding the position of senior managing official will be considered.
Where a member is a trust (through the trustee)	<ul style="list-style-type: none"> Author of the trust, trustee or beneficiary holding more than or equal to 10 percent interest in the trust; or A natural person exercising ultimate effective control over the trust through a chain of control of ownership.
A body corporate (incorporated or registered in India or abroad), other than an LLP	<ul style="list-style-type: none"> The individual holds a majority stake in the member or the ultimate holding company of the member (whether incorporated or registered in India or abroad).
Hindu Undivided Family (HUF)	<ul style="list-style-type: none"> The individual is the Karta (manager) of the HUF.
Partnership entity (through itself or a partner),	<ul style="list-style-type: none"> The individual is – A partner; Holds the majority stake in the body corporate which is a partner of the partnership entity; or Holds the majority stake in the ultimate holding company of the body corporate that is a partner of the partnership entity.
Trust (through a trustee)	<ul style="list-style-type: none"> The individual is – A trustee in the case of a discretionary or charitable trust. A beneficiary in the case of a specific trust. The author or settlor in the case of a revocable trust.



PROVISIONS

Following the implementation of the rule BEN-1, every Significant Beneficial Owner (SBO) or shareholder must submit a declaration within 90 days from the rule's applicability.

If a shareholder conceals information or submits inaccurate or incomplete details, the Company is required to initiate proceedings with the National Company Law Tribunal (NCLT) for necessary actions against the SBO.

Form	Purpose	Timeline
BEN-1	Declaration by the Significant Beneficial Owner.	Within 90 days from the Amendment Rule, 2019.
BEN-2	Return by the Reporting Company.	Within 30 days of receiving the BEN-1 declaration.
BEN-3	Register of Significant Beneficial Owner.	Ongoing maintenance by the Reporting Company.
BEN-4	Notice to Members.	As required by the Reporting Company.

PURPOSE OF ESTABLISHING RULES FOR DISCLOSING SIGNIFICANT BENEFICIAL OWNERS

Lawmakers' primary objective is to uncover the individuals who, though concealed behind the scenes, hold a controlling stake in the business.

Section 89 of the Act mandates that when shares of a company are registered in the name of someone who is not the true owner of those shares, both the registered owner and the beneficial owner must submit a notice to the concerned company. The company is then required to file a statement with the ROC (Registrar of Companies) disclosing this beneficial interest.

Furthermore, the provisions of Section 89 of the Companies Act, 2013 are designed to identify the actual

owners of shares in the company. This is particularly relevant for entities like Hindu Undivided Families and Partnership Firms that may not have members as individuals, as defined by the Act. These provisions enable them to maintain their interests on behalf of the respective parties.

To be effective, changes in the extractive sector should extend beyond mere disclosure of beneficial ownership. They should establish criteria for identifying inappropriate self-dealing or corruption in beneficial ownership arrangements and define the consequences of crossing that line.

BENEFICIAL OWNERSHIP NORMS ACROSS DIFFERENT COUNTRIES

In various countries, the concept of beneficial ownership is defined in diverse ways. For instance, in **Pakistan**, it is linked to direct or indirect financial interests, requiring beneficial owners to report returns on the benefits derived from their beneficial ownership positions.

Mongolia defines a beneficial owner as the actual owner of securities registered in the name of a nominee, entitled to enjoy the benefits of those securities.

Malaysia, the Securities Industry (Central Depositories) Act (SICDA) offers a comprehensive definition of beneficial ownership as the ultimate owner of deposited securities, enjoying all associated rights, benefits and obligations, without excluding any nominee. As a result, beneficial owners in Malaysia are not expressly required to update their ownership details.

On the other hand, only a significant shareholder who is also a beneficial owner is expected to notify a company of their interests and any changes. This principle applies to Hong Kong, China, which does not have explicit definitions for “beneficial ownership.”

In the **Philippines**, a corporate officer must file a beneficial ownership report, even if they do not own any shares in the listed company. Companies in these regions provide information about their principal shareholders (not beneficial owners) in their annual reports, though there are variations in the implementation of these laws.

In **Pakistan**, the emphasis is on disclosing the shareholding structure. In China, Hong Kong, Indonesia, Malaysia, and Singapore, the rules and regulations require the disclosure of “deemed ownership,” which encompasses both direct and indirect (beneficial) ownership.

In **Chinese Taipei**, listed companies must disclose their significant shareholders, defined as those owning 5 percent or more of the shares or being among the top 10 shareholders by shareholding in the annual report. If one of the top 10 shareholders is an institutional investor

acting as a Director or Chief, the name of the investor and the names of its 10 largest shareholders and their respective percentages will be indicated.

Countries rich in natural resources must select beneficial ownership assessment rules that align with their political, legal, and industry realities for license grants.

In **Kenya**, the term “beneficial owner” is broadly defined as the natural person who ultimately owns or controls a legal entity or arrangement, as well as the individual conducting a transaction on their behalf. This definition encompasses not only ownership but also anyone with significant control over a legal entity. The amendment also requires the disclosure of the identity of the natural person(s) in control of the legal entity holding the company’s shares. This necessitates a careful consideration of ownership agreements and structures, addressing both ownership and power, especially when a human individual may hold power rights on a contractual basis without enjoying ownership rights.

Several countries, starting with the United Kingdom in 2016, have established registers of beneficial ownership, some of which are accessible to the public. The European Union’s adoption of the Fifth Anti-Money Laundering Directive in May 2018 requires all EU Member States to enact legislation establishing publicly accessible registers of beneficial ownership information by January 10, 2020.

CONCLUSION

In conclusion, the introduction of rules regarding Significant Beneficial Owners (SBO) in the 2019 amendment to the Companies Act marked a pivotal moment in enhancing corporate transparency and regulatory compliance. These rules were put in place to address the complexities of ownership structures, ensuring that individuals or entities with substantial influence and economic interests in companies are identified and disclosed.

The SBO regulations, as mandated by the Ministry of Corporate Affairs, have played a vital role in promoting accountability, deterring financial misconduct, and combatting practices such as money laundering. They have made it imperative for companies and their shareholders to adhere to stringent reporting requirements regarding SBOs.

The SBO regulations serve as a critical tool in safeguarding the integrity of corporate governance, providing a means to ascertain the true beneficiaries of corporate entities. Compliance with these rules is not only a legal requirement but also a moral and ethical imperative in the corporate world, furthering the goals of transparency and good governance. The 2019 amendment has, therefore, significantly contributed to the evolution of corporate regulation, reinforcing the importance of identifying and disclosing Significant Beneficial Owners in the pursuit of fair and responsible business practices.