

Demystifying Significant Beneficial Ownership under Cos Act, 2013

1. Brief overview

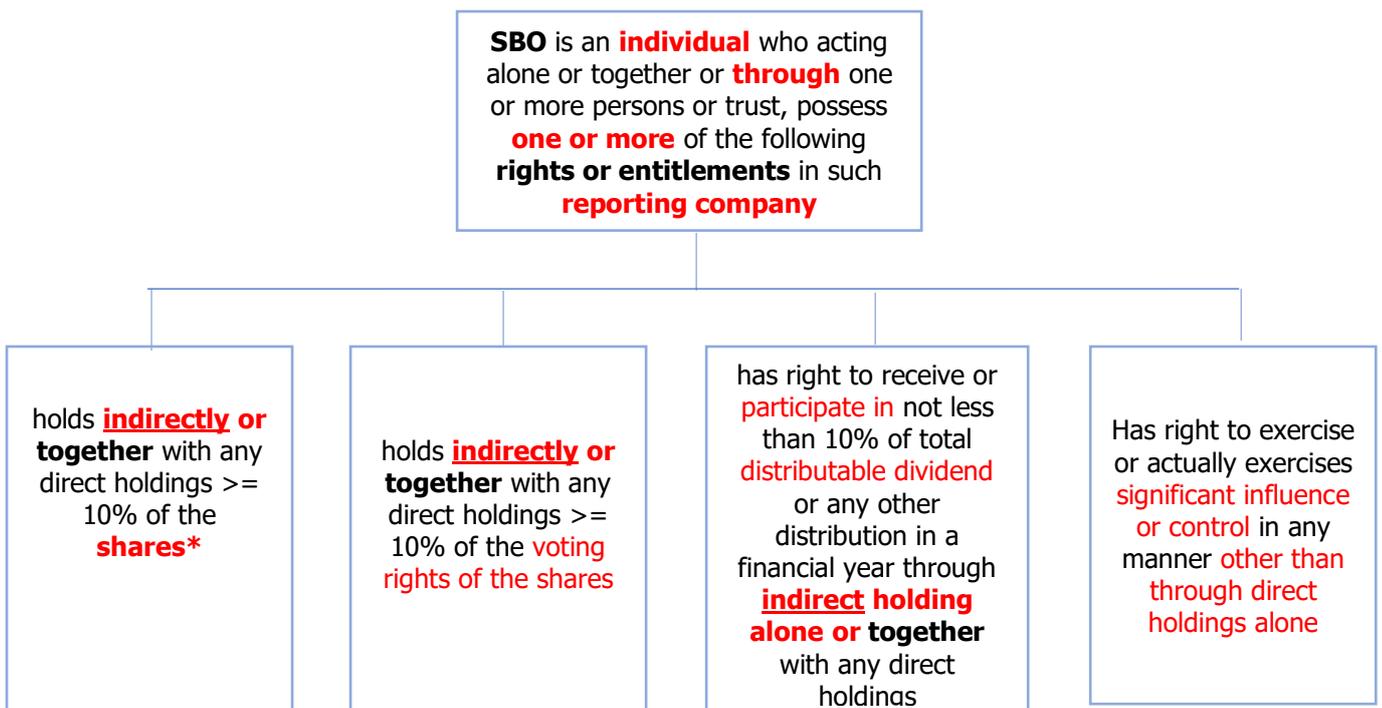
There are numerous companies with layers of investments in each other which makes it tough for the regulators to find out who is the real owner (natural persons) of these Companies. Ministry of Corporate Affairs (MCA) vide notification dated 13/06/2018, had notified the Companies (Significant Beneficial Owners) Rules, 2018 ('SBO Rules') along with Section 90 of the Companies Act, 2013 ('Cos Act, 2013) as amended by the Companies (Amendment) Act, 2017 to unmask the real beneficial owners of the company.

However, since the provisions contained in aforesaid rules were ambiguous and considering the suggestions of various stakeholders, the SBO Rules have been revised vide Companies (Significant Beneficial Owners) Amendment Rules, 2019. The SBO Rules will be effective from date of their publication in the Gazette of India.

This article attempts to demystify the various provisions of the SBO Rules by illustrating various scenarios and help corporates to understand the compliance and procedural requirements and comply with the same in an appropriate manner.

2. Overall scheme of the SBO Rules

2.1 [Who is a Significant Beneficial Owner](#)



* Shares would include global depository receipts (GDR), compulsorily convertible preference shares ('CCPS') or compulsorily convertible debentures ('CCD').

2.2 [Compliance requirements](#)

Provisions of section 90 read with the revised SBO Rules requires the following compliances:

a) **First time compliance upon applicability of the SBO Rules: -**

Compliance By	Form	Timeline	Details
Reporting Company ('Reporting Co')	BEN 4 (Notice)	Not specified but maximum time limit of ninety days for individual to furnish Form BEN 1	The Reporting Co should issue Form BEN 4 to members (other than individuals) holding not less than 10% of its shares or voting rights or right to receive dividend, seeking information about SBO. Further, the Reporting Co should take necessary steps to determine the individual who is a SBO and cause such individual to make declaration in Form BEN 1 .
Individual who is a SBO	BEN 1 (Declaration)	Ninety Days	Every individual, who is a SBO in a Reporting Co should file Form BEN 1 within ninety days from the commencement of the SBO Rules.
Reporting Co	BEN 2 (Return) Application to Tribunal	Thirty Days Fifteen Days	The Reporting co upon receiving Form BEN 1 from the members should file Form BEN 2 with the Registrar within thirty days from the date of receipt of Form BEN 1 along with prescribed fees. In case any person fails to give information as required by Form BEN 4 or the information furnished is not satisfactory , then the Reporting Co shall apply to Tribunal within fifteen day from the expiry of ninety days from the commencement of SBO Rules, seeking restrictions on shares (restriction on transfer or receipt of dividend or suspension of voting right or others).
Reporting Co	BEN 3 (Register of SBO)	Not Specified	The Reporting Co should maintain a register of interest declared by individuals in Form BEN 3 and such register shall be open for inspection by any members of the company on payment of prescribed fees.

b) **Recurring compliance pursuant to first time compliance: -**

Compliance By	Form	Timeline	Details
Individual who is a SBO	BEN 1	Thirty Days	Every individual, who subsequently becomes SBO or whose significant beneficial ownership undergoes any change, should file Form BEN 1 within thirty days of such acquisition or change. If such change takes place within 90 days of the commencement of the SBO rules, then it shall be deemed as if such change has happened on the date of expiry of ninety days and the thirty days for filing shall apply from the expiry of ninety days.
Reporting Co	Same as prescribed above in the first-time compliance. However, from a plain reading of the revised SBO Rules, it is not clear whether the Reporting Co is required to issue Form BEN 4 every time when there is a change in the shareholding pattern anywhere in the chain of holding (from the ultimate beneficial owner till the member of the reporting company).		

3. Consequences of non-compliance with the SBO provisions

The following are the consequences for non-compliance of the SBO provisions

Non-compliance	Provisions dealing with	Consequence and subsequent action	Impact to
Non-furnishing of information or furnishing of non-satisfactory information	Section 90(7) to (10)	<p>Tribunal may issue order directing the shares in questions be subject to restrictions with regard to transfer of interest or receipt of dividend or suspension of voting or all rights attached to shares, etc.</p> <p>However, Tribunal will have to give opportunity of being heard to the parties concerned before passing an order.</p> <p>The Reporting Co or the person aggrieved can make an application to the Tribunal for relaxation or lifting of the restrictions, within one year from the date of such order. If no such application is made, the said shares shall be transferred to the Authority constituted under Investor Education and Protection Fund (IEPF).</p>	<p>a) Reporting Co - it would have to incur significant time and cost to apply to Tribunal</p> <p>b) SBO - Such shares would trigger restrictions</p> <p>c) SBO – Such shares shall be transferred to IEPF and hence loss of ownership of shares</p>
Individual fails to make a declaration in Form BEN 1	Section 90(10)	<p>He shall be punishable with:</p> <ul style="list-style-type: none"> - Imprisonment for a term which may extend up-to one year; or - Fine not less than Rs 1 lakh but may extend up to Rs 10 lakhs; or - Both - Additional fine up to Rs 1,000 per day of default, if the failure is continuing one (after the first). 	SBO
Non-maintenance of register (Form BEN 3) or denies inspection or non-filing of Form BEN 2	Section 90(11)	<p>The company and every officer shall be punishable with fine of not less than Rs 10 lakhs but may extend up to Rs 50 lakhs. Further, additional fine of up to Rs 1,000 per day of default shall be levied if the failure is continuing one (after the first).</p>	Company and every officer

4. Determination of individual who would be a SBO

Given the consequences, it becomes imperative for companies and individuals who are SBO to comply with the aforesaid provisions. However, the most complex issue is to determine the individual who qualifies as a SBO.

Explanation I to clause (h) of Rule 2 provides that where an individual does not hold any right or entitlement **indirectly** under sub clause (i), (ii) or (iii) of clause (h), he shall not be considered as a SBO. Therefore, for an individual to be a SBO, he must possess **indirect holding** in shares or voting rights or right in distributable dividend.

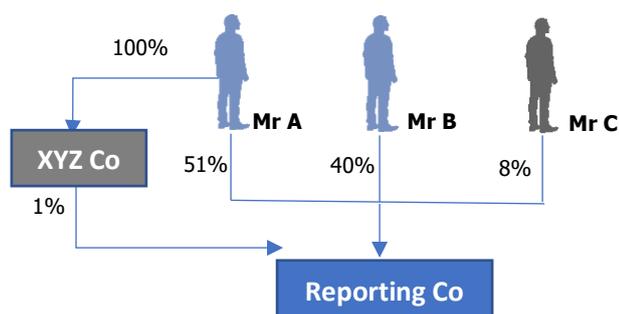
As per Explanation II to clause (h), where the shares are held in the **name of individual** or where the **individual acquires a beneficial interest** in the share of the Reporting co and has made a declaration under section 89 (MGT 4 & MGT 5 as the case may be), then such individual is considered to hold a right or entitlement **directly** in the Reporting co.

However, the difficulty arises when the member or shareholder is non-individual. The SBO Rules prescribes certain criteria for determination of individual where the shares of the Reporting Co are held by person other than individuals, based on the nature or status of member/ shareholder. The same has been tabulated below:

Clause	Where the Member of the Reporting Co is	Individual who is considered to hold a right or entitlement indirectly in the Reporting Co
(i)	Body corporate (including foreign entities), other than LLP	- If he holds Majority Stake ¹ (>50%) in such Body Corporate ; or - If he holds Majority Stake in the Ultimate holding Company of such Body Corporate
(ii)	Hindu Undivided Family (HUF)	- If he is the Karta of that HUF
(iii)	Partnership Entity	- If he is a partner of that partnership entity; or - If he holds Majority Stake in the Body corporate which is a partner of the Partnership entity; or - If he holds Majority Stake in the Ultimate holding company of the Body corporate which is a partner of the Partnership entity
(iv)	Trust	- If he is the trustee of a discretionary trust or charitable trust; or - If he is a beneficiary in case of a specific trust ; or - If he is the author or settlor in case of a revocable trust
(v)	Pooled investment vehicle (PIV) / entity controlled by PIV based in member state of Financial Action Task Force (FATF) and the regulator of the securities market in such member State is a member of International Organisation of Security Commissions	- If he is a general partner of that member; or - If he is an investment manager of that member; or - If he is a Chief Executive Officer where the investment manager of such member is a body corporate or a Partnership entity
(vi)	PIV / entity controlled by PIV which does not fulfil requirements in clause (v) above	The provisions of clause (i) to (iv) as the case may be, shall be applicable

We have enumerated various scenarios for determining the SBO as prescribed in the SBO Rules.

4.1 [Scenario 1 - Vanilla Company with individual as shareholders](#)



In the instant scenario, Mr A holds, indirectly together with direct holdings, more than 10% of the shares and accordingly would be regarded as SBO.

Though Mr B holds more than 10% of the shares in the Reporting Co **directly**, since he does not hold any shares or voting rights **indirectly**, he shall **not** qualify as SBO. Similarly, Mr C would not qualify as SBO.

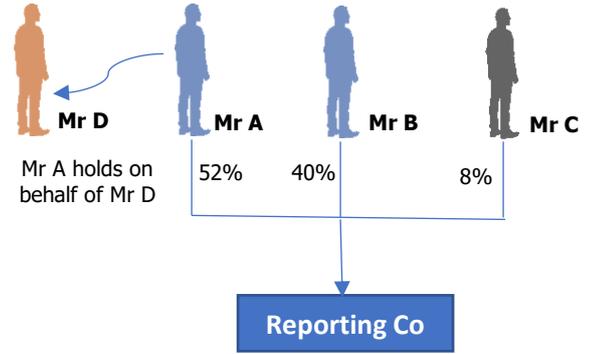
¹ Majority stake means:- (i) holding more than one-half of the equity share capital in the body corporate; or (ii) holding more than one-half of the voting rights in the body corporate; or (iii) having the right to receive or participate in more than one-half of the distributable dividend or any other distribution by the body corporate.

4.2 Scenario 2 - Vanilla Company with different beneficial owner

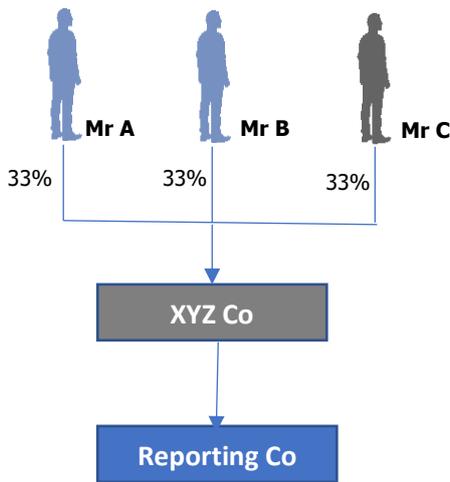
In the given situation, the shares of the Reporting Co are held by 3 individual shareholders, of which, Mr A holds 52% shares on behalf of Mr D and Mr B holds more than 10% of the shares in the Reporting Co.

Accordingly, Mr A, Mr B & Mr D would be considered to hold right or entitlement **directly** in the Reporting Co. Since, they do not have any share or right indirectly, they would not qualify as SBO.

However, if Mr A & Mr D have not filed any declaration in MGT 4 & MGT 5 as prescribed in section 89, then Mr D would be considered as a SBO.



4.3 Scenario 3 - Two-layer company with individual as shareholder



The given situation would fall under clause (i) as per the table above. Since the shares of the Reporting Co is held by a body corporate (XYZ Co), the majority stake held in the body corporate would need to be looked into to determine the individual who is considered as holding right or entitlement indirectly.

Since none of the individual shareholders ie Mr A, Mr B or Mr C holds majority stake in XYZ Co, they would not qualify as SBO.

Though the intent of the SBO provisions is to require reporting of individuals holding more than 10% but the said rules does not capture all such scenario as highlighted above. One would need to evaluate if the said shareholding would trigger reporting under section 90(1) and clause (h) of Rule 2 without referring to the Explanations provided therein.

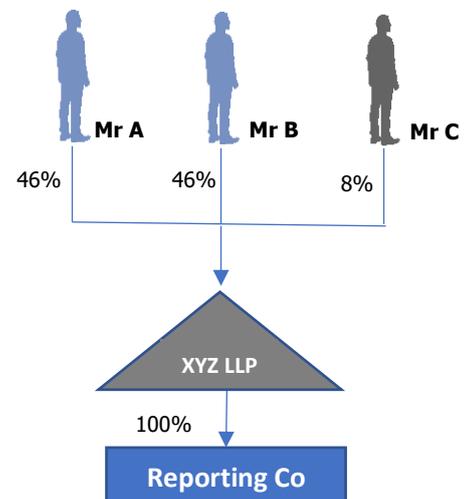
In a case where Mr A, B & C are relative, whether their shares should be clubbed to test the SBO Rules since the words used in the Act & Rules are "**acting alone or together**"? More clarity is required in this aspect.

4.4 Scenario 4 - Company whose shareholder is a partnership entity (including LLP)

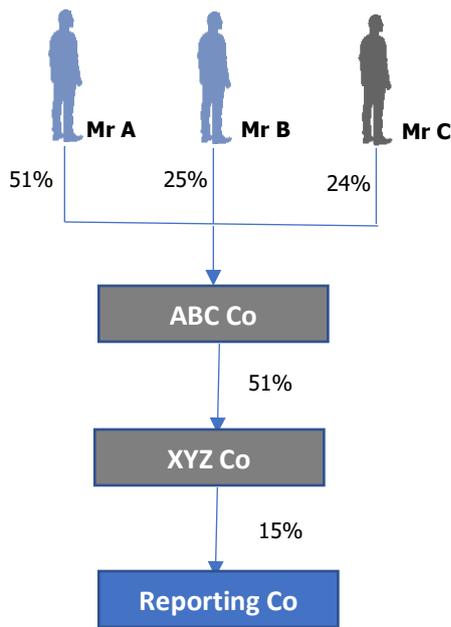
The given situation would fall under clause (iii) as per the table above. Since the shares of the Reporting Co is held by an LLP and only individuals are partners in such LLP, all the partners (i.e. Mr. A, Mr. B & Mr. C) shall be considered as holding right or entitlement indirectly in the Reporting Co.

Accordingly, Mr. A & Mr. B would qualify as a SBO. However, it is not clear whether Mr. C would be considered as SBO as his indirect holding in the Reporting Co is less than 10%. On a conjoint reading of clause (h) with Explanation III, a view can be taken that such individual is not qualified as SBO, though he has right or entitlement indirectly in the Reporting Co.

In a case where the shares are beneficially held by a **partnership firm** (instead of LLP), then as per the provisions of section 89 of the Cos Act, the partners and the Firm are required to file Form MGT 4 & 5 declaring the beneficial interest. Such transaction would fall under **direct holding** as provided in Explanation II and would also fall under **indirect holding** by virtue of clause (iii) of Explanation III, leading to ambiguity. Ideally, such transaction should not require reporting under this provision as would have been already disclosed to the Registrar under Section 89.



4.5 Scenario 5 - Multi-layer company with different shareholders



The given situation would fall under clause (i) as per the table above. Since the shares of the Reporting Co is held by body corporate which is again held by another body corporate, the majority stake of the individual at the ultimate holding company level should be looked into.

In the instant situation, since Mr. A holds majority stake (i.e. >51% of shares) in ABC Co, the ultimate holding company, he shall be considered as having right or entitlement indirectly in the Reporting Co.

However, it can be noted that his effective holding in the Reporting Co shall be only 4% (i.e. 51% * 51% * 15%) and hence he should ideally not be considered as SBO.

5. Exemptions/ non-applicability of SBO provisions in certain cases

The following are the cases wherein the SBO Rules shall not be applicable to the Reporting Co to the extent the shares are held by:

S No	Share held by	Conditions/ remarks
1	IEPF	
2	Holding reporting company	Provided that the details of such holding company are reported in Form BEN 2. This would bring relief as only holding reporting company would be required to comply the provisions in full. However, where the shares are not held 100% by the holding company, then to that extent SBO Rules would trigger.
3	The Central Government, State Government or any local authority or an entity controlled by the Central Government or State Government or partly by the Central or one or more State Government	From the plain reading of the rules, one would note that indirect holding by local authority is not exempted from the applicability of the SBO Rules.
4	Investment Vehicles such as Mutual funds, Alternative investment funds (AIF), Real estate investment trust (REITs), Infrastructure Investment Trusts (InVITs)	Provided they are registered with or regulated by Securities Exchange Board of India (SEBI), as the case may be.
5	All the Investment Vehicles	Provided they are regulated by the Reserve Bank of India, or Insurance Regulatory Authority of India, or pension Fund Regulatory and development Authority.

6. Brief overview of Form BEN 1 & Form BEN 2

Form BEN 1:

The key information required to be provided by the individual in **Form BEN 1** are as follows:

- 1) Along with the name, date of birth and other basic details, the member must disclose his **passport Number** (in case of foreign national).
- 2) Details of indirect holdings i.e. name, type (such as Company / LLP / body corporate/ Trust, etc), address, nature, status of **each of member entity** holding shares or rights in the Reporting Co. In other words, if the individual holds share in the Reporting Co through 5 multilayered entities, the details of each such entity shall be provided in Form BEN 1. In case the member entity is a company or LLP incorporated in India, the CIN or the LLPIN shall also be disclosed.
- 3) Where the SBO holds any direct holding or right in the Reporting Co, he shall also disclose the nature of holding (ie by virtue of shares or voting rights or rights on distributable dividend or exercise of control or exercise of significant influence). In case of exercise of control or significant influence, **the copy of the agreement shall also be enclosed.**

Form BEN 2:

- Form BEN 2 captures all the information required to be disclosed by the individual in Form BEN 1. Further, Form BEN 1 has to be attached along with Form BEN 2 while submitting with the Registrar.
- Form BEN 2 can be filed in respect of multiple individuals and hence one could consolidate all the declaration received from individuals and file the same in one form. However, it needs to be ensured that Form BEN 2 is filed within **30 days of receipt of declaration** and hence while consolidating the BEN 1 declaration, this aspect needs to be considered.
- Form BEN 2 needs to be certified by practicing professional (either Chartered Accountant or Company Secretary or Cost Accountant).

7. Challenges

Though the revised SBO Rules (as compared to the previous rules) defines categorically the individual who is considered to hold a right or entitlement indirectly in the **Reporting Co**, however, it does not address all such scenarios (as highlighted above) resulting in ambiguity / multiple interpretation/ non-compliance.

The issue becomes even **more complex** in case of multilayer companies as the Reporting Co or its officers may not be aware of the ultimate shareholders/ company beyond its parent entity/ shareholder as there is no obligation so far for such companies to collect the said information. Further, the shareholder or the ultimate holding company would be hesitant to disclose the said information to the Reporting Co due to confidentiality or any other commercial reasons.

There are various **phrases** used in the Act and the Rules such as '**acting together**', '**through one or more persons**' which have not been defined, and hence could lead to multiple interpretation. Hence, the Government may clarify the meaning of these phrases in order to avoid multiple views or litigation surrounding the same.

The term '**Significant influence**' has been defined in clause (i) of Rule 2 of the SBO Rules to mean power to participate, directly or indirectly, in the **financial and operating policy decisions** of the Reporting Co but is not control or joint control of those policies. A literal interpretation of the same may include the board of directors or key managerial persons (who may not hold any shares or voting rights) and thereby may trigger the provisions of SBO though the intent is to only identify the beneficial owners of the company.

Further, there could be practical issues in determining the effective holding of the individual as highlighted in scenario 5 where the shares are held by multiple parties through-out the holding chain.

The concept of '**beneficial ownership**' has gained significant importance even under **other laws** such as Income-tax Act, 1961, Foreign Exchange Management Act, 1999, SEBI, Insolvency and Bankruptcy code (IBC) etc. Therefore, reporting of details in Form BEN 1 & Form BEN 2 would require a revisit under such laws to determine if there would be any consequential impact, if not factored earlier.

8. Concluding remarks

There is a famous rule "***Let a hundred guilty be acquitted, but one innocent should not be convicted***". However, the SBO Rules proves to the contrary as it would significantly impact companies who would be required to go through this cumbersome compliance and procedure, and this would impact the ease of doing business in India. Introduction of severe penal provisions (including imprisonment) and restriction on transfer of shares or any other rights is adding fuel to the fire. Further, making the Reporting Co to apply before Tribunal on non-receipt of information or receipt of non-satisfactory information would lead to increase in time and cost for companies and consequent litigation before the Tribunal.

It is recommended that the Government clarifies some of the open issues or issue FAQs and relaxes some of the penal provisions for the initial period till such time the corporates digest this draconian provision. Further, the Government should introduce a redressal or advance ruling mechanism whereby corporates or individual can clarify the determination of the SBO provisions in order to be on the right side of the law and not to trigger any penalty or restrictions. This would help genuine corporates to apply the provisions more fruitfully and would also meet the intent of the Government to track the real beneficial owners by compliance with provisions of the law.

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