Anomalies in Identification and Monitoring of Changes in SBO

The requirement for disclosure of Significant Beneficial Owner (SBO) is an attempt to identify that individual who has the power to control the decisions taken in any company through the non-individual shareholders in the company.

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INTRODUCTION

Money laundering is a menace for all growing economies and all countries aim at having world class mechanisms to combat this evil. One such mechanism is the requirement for identification of significant beneficial owner ("SBO") in all companies registered in India. The mechanism for identification of 'beneficial owner' was already in existence under Prevention of Money-Laundering (Maintenance of Records) Rules, 2005 ("PMLA Rules") and it was implemented as a part of KYC check by banks. But the attempt made by the Ministry of Corporate Affairs ("MCA") to find out SBO at each company level, has created a lot of awareness among corporates and practising professional as it has created disclosure requirements to the MCA and continuous monitoring requirement on the part of corporates. In this article, we will try to deep dive into this concept and also see some probable challenges in continuous monitoring of this mechanism.

CONCEPT OF 'BENEFICIAL INTEREST' AND SIGNIFICANT BENEFICIAL OWNER (SBO) UNDER COMPANIES ACT, 2013

The requirement for disclosure of Significant Beneficial Owner (SBO) is an attempt to identify that individual who has the power to control the decisions taken in any company through the non-individual shareholders in the company.

The Companies Act, 2013 ("CA 2013") deals with two types of beneficial interest / ownership:

(i) One is the 'beneficial interest' owned by a 'beneficial owner' (who may or may not be an individual), which is regulated under Section 89 of CA 2013.

(ii) Another is the 'beneficial interest' owned by a 'significant beneficial owner' (who must mandatorily be an individual), which is regulated under Section 90 of CA 2013.

For the purpose of both Sections 89 and 90, the term 'beneficial interest' is defined in Section 89(10) as "*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"

This means following are the characteristic features of beneficial interest:

(a) It is a right or entitlement of a person (individual or non-individual) in a share.

(b) It may be direct or indirect.

(c) It may be through any contract or arrangement or through any other mode.

(d) It may be of that person alone or of that person together with any other person.

(e) It may mean the right or entitlement to (1) exercise or (2) cause to be exercised, any or all of the rights attached to such share

(f) It may mean the right or entitlement to receive or participate in any dividend or other distribution in respect of such share

If there is any right of any person of above nature in the shares issued by any company, it means the person has beneficial rights in such shares. Such person may even be the registered owner of shares, whose name is entered in the register of members as owner of those shares. Conversely such person may be some other person who is not the registered owner of those shares but who has the above-mentioned type of rights or entitlement over those shares.

ARTICLE

ORIGIN OF SBO CONCEPT UNDER CA 2013

Section 90 was always a part of CA 2013 and it was notified with effect from 1 April 2014. However, earlier Section 90 stated that *"Where it appears to the Central Government that there are reasons so to do, it may appoint one or more competent persons to investigate and report as to beneficial ownership with regard to any share or class of shares and the provisions of section 216 shall, as far as may be, apply to such investigation as if it were an investigation ordered under that section."* At that time, it was the prerogative of the Central Government to investigate the beneficial ownership of any share in any company.

Thereafter, Section 90 was amended with effect from 13 June 2018 and Section 90 now reads as *"(1) 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 (herein referred to as "significant beneficial owner"), shall make a declaration to the company, specifying the nature of his interest and other particulars, in such manner and within such period of acquisition of the beneficial interest or rights and any change thereof, as may be prescribed:*

Provided that the Central Government may prescribe a class or classes of persons who shall not be required to make declaration under this Sub-Section."

This was a very important change through which the MCA started to run, as a campaign, the requirement to disclose SBO of each company. The Rules for identification of SBO were also notified as the Companies (Significant Beneficial Owners) Rules, 2018 ("SBO Rules") on 14 June 2018 but were kept on hold and were subsequently modified with effect from 8 February 2019.

Comparison of Section 90(1) with Section 89(10)

If we compare Section 90(1) with the definition of 'beneficial interest' given in Section 89(10), it appears that any individual who holds beneficial interests, of not less than 25% or such other percentage as may be prescribed in share of 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 is the SBO and he is required to make disclosure of his beneficial interest.

This creates an impression that even such shareholder who directly holds more than 25% shareholding in a company, in his own name registered in the register of members, might be considered as SBO and might be required to make disclosure. But this information would already be disclosed by companies in their Annual Returns being in filed in MGT-7 in the form of shareholders list. This is where the beneficial interest which may be held through the non-individual shareholders of a company might get missed off. Hence there was a need for defining a separate framework for identification of SBO in case of non-individual shareholders.

Therefore Section 90(1) lays down the principle of identification of SBO, i.e.:-

- Such individual may be acting alone OR
- Such individual may be acting together with one or more persons or trust, including a trust and persons resident outside India OR
- Such individual may be acting through one or more persons or trust, including a trust and persons resident outside India

IDENTIFICATION OF SBO AS PER SBO RULES

(1) Definition of SBO as per SBO Rules:-

The term 'SBO' is defined in Rule 2(1)(h) of SBO Rules as, *"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:*

(i) holds indirectly, or together with any direct holdings, not less than ten percent, of the shares;

(ii) holds indirectly, or together with any direct holdings, not less than ten percent, 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;

(iv) has right to exercise, or actually exercises, significant influence or control, in any manner other than through direct-holdings alone:

Anomaly - Who is SBO? The individual holding not less than 25% beneficial interest OR the individual holding not less than 10% beneficial interest?

The threshold mentioned in this definition of SBO in SBO Rules can be said to be deviating from the threshold limit laid down in Section 90(1), which speaks about holding beneficial interests, of not less than 25%. or such other percentage as may be prescribed. But the threshold of holding prescribed in Rule 2(1)(h) is not less than 10% Hence, a question arises that whether an individual who is holding beneficial interest of more than 10% but less than 25% is SBO and is he required to make disclosure of his beneficial interest?

If we see the Preamble of the SBO Rules, it says these Rules are notified *"in exercise of the powers conferred by Section 90 read with sub-section (I) of section 469 of the Companies Act, 2013..."* As per Section 469 of CA 2013, *"The Central Government may, by notification, make rules for carrying out the provisions of this Act."*

Hence, a view can be taken that although Section 90(1) requires only such individuals who hold beneficial interest of not less than 25% in a company to disclose, but since SBO Rules are issued in exercise of powers conferred upon Central Government by Section 90 as well as Section 469, these SBO Rules might prescribe something over and above what is prescribed under Section 90. Hence, the process of identification of SBO must be done as per the SBO Rules.

(2) Principles for identification of SBO

Rule 2(1)(h) lays down the principle of identification of SBO in line with Section 90(1), i.e.:-

- Such individual may be acting alone OR
- Such individual may be acting together with one or more persons or trust, including a trust and persons resident outside India OR
- Such individual may be acting through one or more persons or trust, including a trust and persons resident outside India.

And such individual must possess one or more of the rights or entitlements mentioned in Rule 2(1)(h).

Explanation I to this definition says that *"if an individual does not hold any right or entitlement indirectly under sub-clauses (i), (ii) or (iii), he shall not be considered to be a significant beneficial owner."* Sub-clause (iv) mentions that right to exercise, or actually exercises, significant influence or control should be other than through direct holdings alone.

Hence, the essence of this SBO definition as per SBO Rules is that indirect holding or indirect right or entitlement is a MUST for an individual to be an SBO. Incidentally, he may have direct holdings too in the reporting company.

Therefore it becomes very important to understand what is meant by 'direct holding', so as to understand what is excluded from indirect holding?

Explanation II to this definition says that – *"For the purpose of this clause, an individual shall be considered to hold a right or entitlement directly in the reporting company, if he satisfies any of the following criteria, namely.'*

(i) the shares in the reporting company representing such right or entitlement are held in the name of the individual;

(ii) the individual holds or acquires a beneficial interest in the share of the reporting company under Sub-Section (2) of section 89, and has made a declaration in this regard to the reporting company."

This Explanation II clarifies that if an individual is holding the shares in his own name, then although he holds beneficial interest in those shares (as defined under Section 89(10), but for the purposes of Section 90(1), he will not be considered as SBO and hence there is no requirement to disclose under Section 90(1).

Another category of direct holding explained in this Explanation II is about individual holding beneficial interest under section 89(2). This section 89(2) says *"Every person who holds or acquires a beneficial interest in share of a company shall make a declaration to the company specifying the nature of his interest, particulars of the person in whose name the shares stand registered in the books of the company and such other particulars as may be prescribed."* Under Rule 9 of the Companies (Management and Administration) Rules, 2014, these particulars are prescribed to be disclosed by the registered owner of shares to the company in MGT-4 format and by the beneficial owner to the company in MGT-5 format, and the company is required to file e-form MGT-6 with MCA by attaching the declarations received in MGT-4 and MGT-5 formats.

Anomaly – Can an individual hold beneficial interest in shares which are not registered in his own name?

If we observe section 89(2), it says about a 'person' holding beneficial interest in shares. Section 2(42) of the General Clauses Act, 1897 defines that 'person' shall include any company or association or body of individuals, whether incorporated or not. Hence, the holder of beneficial interest as per Section 2(89) may be individual or any other entity. This scenario frequently exists in case of shares of a wholly owned subsidiary where for the purpose of maintaining minimum two shareholders[1] (in case of private company) or minimum seven shareholders (in case of public companies), the holding company needs to arrange nominee shareholders who become the registered owner of some minimal number of shares (generally 1 share) in the wholly owned subsidiary, for which beneficial ownership is held by the holding company.

However, the clause (ii) of Explanation II of SBO definition as per SBO Rules speak about an individual holding beneficial ownership and having filed the disclosures in MGT-4 and MGT-5 format. Hence a question arises that what can be such scenarios and whether such scenarios are valid under law?

Even before notification of Section 90 in CA 2013, there has been the Prohibition of Benami Property Transactions Act, 1988 which prohibits entering into any benami transaction. This transaction defined 'benami transaction' but exempts the below mentioned situations from being considered as 'benami transaction' when any property (including shares) are held by:

(i) a Karta, or a member of a Hindu undivided family, as the case may be, and the property is held for his benefit or benefit of other members in the family and the consideration for such property has been provided or paid out of the known sources of the Hindu undivided family;

1. *Proviso to section 187(1) of CA 2013 permits a company to hold shares in its subsidiary company in the name of any nominee or nominees of the company, if it is necessary to do so, to ensure that the number of members of the subsidiary company is not reduced below the statutory limit.*

(ii) a person standing in a fiduciary capacity for the benefit of another person towards whom he stands in such capacity and includes a trustee, executor, partner, Director of a company, a depository or a participant as an agent of a depository under the Depositories Act, 1996 and any other person as may be notified by the Central Government for this purpose;

(iii) any person being an individual in the name of his spouse or in the name of any child of such individual and the consideration for such property has been provided or paid out of the known sources of the individual;

(iv) any person in the name of his brother or sister or lineal ascendant or descendant, where the names of brother or sister or lineal ascendant or descendant and the individual appear as joint owners in any document, and the consideration for such property has been provided or paid out of the known sources of the individual;

Therefore, it can be said that if any individual is holding shares of a reporting company under any of the above-mentioned scenarios, then it can be considered as a valid transaction and such individual can hold beneficial interest in shares.

As per the Explanation II given in the definition of SBO under SBO Rules, in such scenarios, the individual in whose name the shares are registered and that individual who holds beneficial interest in the shares should give the declarations in MGT-4 and MGT-5 formats respectively to the company. Only then such holdings will be considered as direct holding and such individual will not have any actionable under Section 90 of CA 2013

(3) Who shall be the SBO in case of different categories of equity shareholders and complexities involved therein?

The Explanation III in Rule 2(1)(h) under SBO Rules provides guidance on who shall be the SBO in case of different categories of shareholders (members) of a reporting company. Further Explanation V in the definition of SBO states that *"For the purpose of this clause, if any individual, or individuals acting through any person or trust, act with a common intent or purpose of exercising any rights or entitlements, or exercising control or significant influence, over a reporting company, pursuant to an agreement or understanding, formal or informal, such individual, or individuals, acting through any person or trust, as the case may be, shall be deemed to be 'acting together'.*

Since the manner of identification of SBO is given in the definition by way of Explanations, it is important to note that an explanation added to a statutory provision is not a substantive provision in any sense of the term. As the plain meaning of the word 'explanation' itself shows, it is merely meant to explain or clarify certain ambiguities which may have crept in the statutory provision. Explanation cannot change the enactment and it cannot take away any right.[2]

[2] *Sundaram Pillai Vs. VR Pattabiraman (AIR)1985SC 582*

> The essence of this SBO definition as per SBO Rules is that indirect holding or indirect right or entitlement is a MUST for an individual to be an SBO. Incidentally, he may have direct holdings too in the reporting company.

Hence it is important to understand these Explanations in the light of the principle of identification of SBO laid down in Rule 2(1)(h) of SBO Rules as well as in Section 90(1). Let us discuss some complexities involved in this identification process by taking different situations:-

(A) **In case the member of reporting company is a body corporate (incorporated in or outside India) other than LLP:**

As per clause (i) of Explanation III, if the member is a body corporate (whether incorporated or registered in India or abroad), SBO is that individual who,

(a) holds majority stake in that member; or

(b) holds majority stake in the ultimate holding company (whether incorporated or registered in India or abroad) of that member.

The term "majority stake" is defined in Rule 2(1)(d) of SBO Rules to mean:

(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.

This indicates that in case a company / body corporate holds more than 10% shares in a reporting company, then the individual who holds more than 50% equity shares or voting rights or right to distribution in that member company / body corporate or its ultimate holding company is the SBO of the reporting company to the extent the shares held by such member company / body corporate.

Situation 1: A Pvt. Ltd. is the reporting company and 5% shares are held by B Pvt. Ltd. and 6% shares are held by C Pvt. Ltd. The majority stake in B Pvt. Ltd. and C Pvt. Ltd. is held by one single

individual, say Mr. X. Then a question arises whether Mr. X is an SBO for A Pvt. Ltd. or not?

If we see the opening words of Rule 2(1)(h), it says *"an individual .... who acting alone or together, or through one or more persons.... holds indirectly, ... not less than ten percent, of the shares..."*

In this situation, Mr. X holds indirectly, through not a single company, but through two companies, 11% of the shares of A Pvt. Ltd. Hence, even if B Pvt. Ltd. or C Pvt. Ltd. do not hold 10% shares in A Pvt. Ltd., still Mr. X will be considered as SBO through B Pvt Ltd & C Pvt. Ltd.

Situation 2: X Pvt. Ltd. is the reporting company and 5% shares are held by Y Pvt. Ltd. and 6% shares are held by Mr. Z. The majority stake in Y Pvt. Ltd. is held by none other than Mr. Z. Then a question arises whether Mr. Z is an SBO for X Pvt. Ltd. or not?

Again if we see the opening words of Rule 2(1)(h), it says *"an individual .... who acting alone or together, or through one or more persons.... holds indirectly, or together with any direct holdings, not less than ten percent, of the shares..."*

In this situation, Mr. Z holds indirectly only 5% shares but directly he holds 6% shares, and taken together he holds 11% shares of X Pvt. Ltd. Hence, even if Y Pvt. Ltd. do not hold 10% shares in X Pvt. Ltd., still Mr. Z will be considered as SBO through Y Pvt. Ltd.

Situation 3: In the above example if majority stake in Y Pvt. Ltd. was held by the spouse or any other relative of Mr. Z, then whether Mr. Z is an SBO for X Pvt. Ltd. or not?

In such situation, Mr. Z needs to determine whether his spouse or the other relative who is majority stakeholder in Y Pvt. Ltd. is a person acting together (as per Explanation V) with Mr. Z or not? If such person is a person acting together with Mr. Z, then Mr. Z will have to consider himself as SBO and will have to give disclosure to the reporting company, i.e., X Pvt. Ltd. in BEN-1 format. If Mr. Z feels that his spouse or the other relative is not a person acting together with him, then he may claim that he is not SBO in X Pvt. Ltd., but the onus of proving this will be on Mr. Z, in case MCA raises a question in future.

(B) In case the member of reporting company is HUF:

As per clause (ii) of Explanation III, if the member is a Hindu Undivided Family (HUF) (through Karta), the individual who is the Karta of the HUF is the SBO.

This appears quite clear that if HUF holds more than 10% shares in reporting company, then its Karta will be the SBO to the extent the shares are held by HUF. However there can be some complex situations as mentioned below:

Situation: A Pvt. Ltd. is a reporting company and one HUF holds 5% shares in A Pvt. Ltd. One of the co-parceners of the HUF holds 6% shares in A Pvt. Ltd. in his own name (directly). This raises a query that whether the Karta will be co-parcener in this case?

Again if we see the opening words of Rule 2(1)(h), then it says *"an individual .... who acting alone or together, or through one or more persons.... holds indirectly, or together with any direct holdings, not less than ten percent, of the shares..."*

As per Section 2(77) of CA 2013, two members of a HUF are considered as relatives. In this situation also, the Karta has to decide whether the co-parcener is a person acting together with him (as per Explanation V). If yes, then the Karta may declare to A Pvt. Ltd. by giving declaration in BEN-1 format that through the HUF and through that co-parcener, the Karta holds more than 10% shares in A Pvt. Ltd. If the Karta feels that he is not acting together with this co-parcener, then he may claim that he is not SBO in A Pvt. Ltd., but the onus of proving this will be on the Karta, in case MCA raises a question in future.

(C) In case the member of reporting company is partnership firm or LLP:

As per clause (iii) of Explanation III read with the definition of 'partnership firm' in Rule 2(1)(e) of SBO Rules, if the member is a partnership firm or LLP, then the SBO is that individual who-

(a) is a partner; or

(b) holds majority stake in the body corporate which is a partner of the partnership entity; or

(c) holds majority stake in the ultimate holding company of the body corporate which is a partner of the partnership entity.

Situation: X Pvt. Ltd. is reporting company and Y LLP holds more than 10% shares therein. Y LLP has two partners – Mr. A and ABC Pvt. Ltd. As per LLP Agreement of Y LLP, all decisions shall be taken only with the consent of ABC Pvt. Ltd. and Mr. A does not have any decision-making right. The majority stakeholder of ABC Pvt. Ltd. is Mr. D. There is no relationship between Mr. A and Mr. D. In this case, a question arises that Mr. A has no say of his own, with regard to the decisions done by Y LLP, will he still be considered as SBO of X Pvt. Ltd.?

In this case, the clause (iii) of Explanation III is very clear and unambiguous and it says an individual who is a partner of the LLP or partnership firm will be SBO. Hence, irrespective of whether Mr. A has any powers in Y LLP or not, he will be considered as SBO to the extent the shares of X Pvt. Ltd. are held by Y LLP.

(D) In case the member of reporting company is a trust:

As per clause (iv) of Explanation III, if the member is a Trust, then depending on the nature of the trust, below individuals shall be the SBO -

(a) in case of discretionary trust or a charitable trust – trustee is the SBO;

(b) in case of specific trust - beneficiary is the SBO;

(c) in case of a revocable trust - author or settlor is the SBO.

Situation: PQR Pvt. Ltd. is reporting company and ABC Trust, a discretionary trust holds more than 10% shares therein. The trustee of ABC Trust is a trustee company, and the majority stakeholder of that trustee company is Mr. A. Whether Mr. A will be considered as SBO?

Again if we see the spirit of the definition of SBO, then it says *"an individual .... who acting alone or together, or through one or more persons.... holds indirectly, ... holdings, not less than ten percent, of the shares..."*

In this case, although there is no individual who is a trustee of this trust, but all decisions on behalf of the trust are taken by the trustee company and the manner in which the trustee company will take decisions is in control of Mr. A, being the majority stakeholder. Hence, Mr. A will be considered as SBO to the extent the shares are held by the Trust in PQR Pvt. Ltd.

(E) In case the member of reporting company is a pooled investment vehicle or an entity controlled by it:

Situations where member is a pooled investment vehicle or entity controlled by it are covered under clause (v) of Explanation III and as per Explanation IV of Rule 2(1)(h). If such entity is based in a member State of the Financial Action Task Force on Money Laundering and the regulator of the securities market in such member State is a member of the International Organization of Securities Commissions, then the SBO in relation to the pooled investment vehicle shall be below individuals -

(A) a general partner; or

(B) an investment manager; or

(C) a Chief Executive Officer where the investment manager of such pooled vehicle is a body corporate or a partnership entity.

As per the said Explanation IV, if the member of reporting entity, being a pooled investment vehicle or an entity controlled by it does not fulfil the above requirements, then depending on the nature of the entity, the SBO will have to be determined as explained in the above paras, i.e., as per clause (i) or (ii) or (iii) or (iv) of Explanation III, as the case may be.

Investment Vehicles regulated by RBI or SEBI

There can be other pooled investment vehicles or other investment vehicles holding shares in reporting company, such as mutual funds, Alternate Investment Fund (AIF), Real Estate Investment Trusts (REITs),

infrastructure Investment Trust (InVITs) which are regulated by SEBI or Investment Vehicles regulated by RBI, or Insurance Regulatory and Development Authority of India (IRDAI), or Pension Fund Regulatory and Development Authority.

As per Rule 8 of SBO Rules, to the extent shares of reporting company are held by any of these entities which are regulated by any of the above- mentioned regulators, there will be no SBO and no disclosure requirement under section 90(1).

(F) In case the member of reporting company is Government / Government entity or Investor Education & Protection Fund (IEPF):

Rule 8 of SBO Rules also exempts the applicability of SBO Rules to the extent the shares of reporting company are held by Central Government, State Government or any local Authority or a reporting company, or a body corporate, or an entity, which is controlled by the Central Government or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, and also to the extent shares are held by IEPF.

Hence in such cases where the shareholder is a Government company / Government / Government controlled entity and to the extent shares of the reporting company are transferred to IEPF as required under Section 124(6), there will be no SBO and no disclosure requirement under Section 90(1).

(4) SBO in cases of securities other than equity shares:-

Explanation VI of Rule 2(1)(h) of SBO Rules deals about situations where reporting company may have issued global depository receipts (GDRs), compulsorily convertible preference shares (CCPs) or compulsorily convertible debentures (CCDs). Explanation VI says that *"for the purpose of this clause, these instruments shall be considered as 'shares'"*

Anomaly 1 – There can be situations where the face value of CCPs or CCDs are not same as the face value of equity shares. In such cases, ignoring the aggregate value of these securities and simply aggregating the number or units of these securities issued and the number or units of equity shares issued may not give the correct picture about who is the SBO. In such situations, one needs to decide whether to aggregate the total value of these securities issued and the total value of equity shares issued and then arrive at who is the SBO, and accordingly the disclosure under section 90(1) may be made.

Anomaly 2 – A query arises that how to calculate the total number of shares in case the reporting company has issued non-convertible or optionally convertible preference shares (OCPs / NCPs)? This Explanation VI is silent about whether to treat them as shares or not for the purpose of this clause. However, as per Section 43 of CA 2013, all kinds of preference shares are also a kind of share, which will include even OCPs and NCPs. In such situations, one needs to decide that even if Explanation VI is silent, whether to aggregate the total value OCPs / NCPs issued and the total value of equity shares issued and then arrive at who is the SBO, and accordingly the disclosure under Section 90(1) may be made.

Anomaly 3 – Although Explanation VI says that *"for the purpose of this clause, CCPs, CCDs shall be considered as 'shares'"*, but these securities do not have any voting rights. Hence a query arises that how to make disclosure for these securities while preparing the disclosure under Section 90(1)? In such cases, a view may be taken that for these securities, disclosure maybe made by indicating only 'shares' category and not indicating anything in 'voting rights' category in the disclosure under Section 90(1), i.e., in BEN-1 format. Thereafter when these securities will get converted into equity shares, another disclosure be made wherein the proportion of shares as well as voting rights held through them may be i ndicated.

(5) SBO in cases where control or significant influence exists irrespective of shareholding:-

Section 90(1) as well as the definition of SBO in SBO Rules speak about a situation where an individual has:

(a) right to exercise, or (b) the actual exercising of

(i) significant influence or (ii) control

The term 'significant influence' has been explained in Explanation VI of Rule 2(1)(h) of SBO Rules as *""significant influence" means 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."*

Section 90(1) says that the term 'control' is to be read as it is defined in Section 2(27) of CA 2013, i.e., as *""control" shall include the right to appoint majority of the Directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner."*

Section 89(10) explains that the beneficial interest may be through any contract, arrangement or otherwise. The definition of SBO in Rule 2(1)(h) of SBO Rules say that this significant influence or control should be in any manner other than through direct holdings alone.

A combined reading of all these provisions indicates that there can be a situation where an individual may not be holding shares or voting rights or right to receive or participate in distributable dividend or other distribution of 10% or more in the reporting company, but still such individual may have significant influence or control through any contract, arrangement or otherwise in the reporting company. A very common example is the existence of such rights through a Shareholders Agreement, wherein the reporting company may or may not be a party to the agreement, and such agreement may or may not have been incorporated in the Articles of Association of the Company. In such cases also, such individual will be considered as SBO and he will have to disclose his beneficial interest to the reporting company under section 90(1).

These are the various methods by which SBO of a reporting company can be identified. The below checks need to be followed for identification of SBO:-

- While analysing whether an individual is SBO or not, there can be 2 approaches – Rule based approach and Principle based approach.
- The principles of "significant influence", "control" and "acting together", "acting through" must be checked over and above Rule based approach.
- In case of holding by LLP / partnership entity, all individual partners can be said to be "acting together".
- In case of holding by body corporate entity, the holding of majority stake by person acting together can be the deciding factor for identifying SBO.

As per Section 90(1) and as per Rule 3 of SBO Rules, the SBO has the obligation of disclosing his interest to the reporting company in BEN-1 format within 30 days of acquiring the significant beneficial ownership. Even thereafter, the SBO needs to keep monitoring any change and needs to make further disclosure, in the same BEN-1 format, within thirty days of any further change.

WHEN SHOULD SBO INTIMATE THE CHANGE TO REPORTING COMPANY

As per Section 90(1) and as per Rule 3 of SBO Rules, whenever there is any change, the SBO needs to give disclosure in BEN-1 format to the reporting company. This raises an anomaly that what should be considered as 'change'?

Anomaly – An anomaly arises that in which of the below mentioned situations further intimation in BEN-1 is to be given:-

(i) When the SBO ceases to be SBO OR

(ii) When there is some major change in indirect holding of shares of SBO but that individual continues to be the SBO OR

(iii) When there is some minor change in indirect holding of shares of SBO OR

(iv) When there is any change in direct shareholding of SBO OR

(v) When there is change in any other shareholder in the reporting company due to which there is a change in the contents of BEN-1 made earlier for eg:

  (a) Allotment of shares to any other shareholder OR

  (b) Transfer of shares held by any other shareholder in favour of any other person OR

  (c) When there is buy back of shares or reduction of share capital in reporting company or any change pursuant to scheme of arrangement OR

  (d) Even because of allotment of shares exercised under ESOP scheme.

(vi) When there is any such change in the ownership structure of the member non-individual entity.

This is the biggest anomaly in the entire mechanism of SBO as the wordings of Section 90(1) as well as Rule 3 is *'any change thereof / therein'*. Hence it is required to continuously monitor any change in any of the above kinds and make disclosure in BEN-1 wherever the context requires to disclose and take a conservative view and disclose wherever possible.

Another anomaly arises at the reporting company level after receipt of BEN-1 for intimation of change. As per Section 90(4) read with Rule 4 of SBO Rules, the reporting company needs to file the BEN-1 received with the MCA in e-form BEN-2. However, in e-form BEN-2, there is no specific point to mention the 'date of change'. This creates even more confusion with regard to the manner of filling the e-form BEN-2 in case of BEN-1 received for any change.

OBLIGATIONS OF REPORTING COMPANY

There are multiple obligations on the reporting company, which can be listed down as follows:-

(1) To file a return in e-Form BEN-2 with MCA in respect of BEN-1 received from SBO(s), within 30 days from receipt of such BEN-1. [Section 90(4) read with Rule 4 of SBO Rules]

It may be noted that if the reporting company has any holding company as its member, then if the holding company has filed e-form BEN-2, then the subsidiary may file e-form BEN-2 by mentioning the CIN of the holding reporting company, and the SBO of the holding company may not give a separate BEN-1 to such subsidiary. [Rule 8 of SBO Rules]

(2) If the reporting company is a listed entity, then to disclose the names of SBOs in the Quarterly Shareholding Pattern to be filed with stock exchanges where it is listed, under Regulation 31 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

(3) To maintain a register of SBO in Form No. BEN-3 and to keep the Register open for inspection by members of the Company [Section 90(2) and (3) read with Rule 5 of SBO Rules.]

(4) Whenever there is any change in the structure of shareholding (or even change in CCPs or CCDs) in the reporting company, to identify if there might be a possible change in the contents of BEN-1 given earlier? If yes, then to send notice to such member in BEN-4 format. [Section 90(4A) and (5) read with Rule 2A of SBO Rules]

(5) To apply to NCLT if:-

(a) Where any person fails to give the information required by the notice in Form BEN-4, within 30 days from the date of sending BEN-4 (as prescribed under section 90(6)) OR

(b) Where the information given is not satisfactory.

within 15 days of expiry of the time specified in BEN-4, for order directing that the shares in question be subject to restrictions, including:

i. Restrictions on the transfer of interest attached to the shares in question;

ii. Suspension of the right to receive dividend or any other distribution in relation to the shares in question;

iii. Suspension of voting rights in relation to the shares in question;

iv. Any other restriction on all or any of the rights attached with the shares in question.

CONCLUSION

The entire concept of SBO introduced under Section 90 and SBO Rules is a very noble concept and aims to curb the practices of money laundering, round tripping of funds through a series of corporate entities and to bring to the surface the ultimate individual who has the power to take decisions in any company. The initial disclosure of SBO would have been done by most of the corporate entities since the time it was introduced. However, there are lot of anomalies in continuous monitoring of any change and further disclosures required to be done to the reporting company and to the MCA. Section 90 is under in-house adjudication mechanism of Registrar of Companies (ROC) and off late, ROCs have been sending show cause notices to various companies for disclosure lapses. If MCA can prescribe a more elaborate and comprehensive framework for intimating the changes in SBO and clarify what shall be considered as 'change', then it will help the corporate sector as well as MCA for effective monitoring of SBO on a continuous basis.