

Intricacies of SBO in the Context of Limited Liability Partnership

Section 89 of Companies Act, 2013 (Cos Act) mandates disclosure of beneficial interest by nominee and beneficial owner. Sub Section (10) of Section 89 of Cos Act lays down two principles for determining who has beneficial interest (a) person who exercises or causes to exercise any rights attached to shares (b) person who receives or participates in dividend or distribution in respect to such share. If there is any difference between member entered in register of member and person who has any of above right or entitlement, disclosure triggers under Section 89. However, if member is corporate body, Section 89 does not insist to go beyond the legal entity to find out who has beneficial interest.



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INTRODUCTION

Two notifications one dated 11 February 2022 and dated 27 October 2023 the compliances of significant beneficial owner (SBO) and disclosures of beneficial interest (BI), respectively, has been made applicable to all Limited Liability Partnership(s) (LLP). While making SBO and BI applicable to LLP, framework applicable to companies has been taken as a base and some minor modifications have been made and adopted. Though both company and LLP enjoy limited liability and are incorporated bodies, other features are completely different and hence adopting SBO framework applicable to Companies for LLP, gives rise to lot of ambiguities and anomalies. Both notifications are effective from their date of publication in official gazette and hence it is urgent and important for every LLP and its designated partners need to be aware about it.

FRAMEWORK UNDER COMPANIES ACT FOR SBO/ BI IN COMPANIES

Section 89 of Companies Act, 2013 (Cos Act) mandates disclosure of beneficial interest by nominee and beneficial owner. Sub Section (10) of Section 89 of Cos Act lays down two principles for determining who has beneficial interest (a) person who exercises or causes to exercise

any rights attached to shares (b) person who receives or participates in dividend or distribution in respect to such share. If there is any difference between member entered in register of member and person who has any of above right or entitlement, disclosure triggers under Section 89. However, if member is corporate body, Section 89 does not insist to go beyond the legal entity to find out who has beneficial interest. Section 89 (10) predominantly relies upon exercise of rights attached to shares and dividend in respect of such shares. Please note that in LLP there is not concept of shares or share capital or dividend.

Section 90 of Cos Act goes to next level. It relies on beneficial interest term used in Section 89(10) and goes on to lift the veil of legal entities appearing in register of members to find out individual who has control of those entities. Section 90 (1) read with rule 2(1)(h) of Companies (Significant Beneficial Owner) Rules 2018 (SBO Rules) lays down 4 tests to identify who is individual significant beneficial owner (a) individual who holds not less than 10% shares (b) individual who holds not less than 10% voting rights in shares (c) individual who receives or participates in not less than 10% dividend or other distribution linked to shareholding (d) individual who has right or exercises significant influence or control. An individual may be exercising it directly or indirectly, alone, or together. Explanation I to VI to rule 2(1)(h) explain how to determine direct, indirect, and together. Explanation III and IV to rule 2(1)(h) explains how to determine indirect holding considering various types of shareholders appearing in register of members like company, firm, trust, HUF or pooled investment vehicles.

But again 3 out of 4 parameters directly depend on term share/ share capital. 'Share Capital' concept under Cos Act plays a very important role to determine who is owner or who has beneficial interest. Both voting rights and dividend rights are generally linked to how much paid-up share capital one holds in the company. While implementing concept of beneficial interest as a partner in LLP, regulator tries to rely on term contribution used in Limited Liability Partnership Act, 2008 (LLP Act).

NOTIFICATION 11 FEBRUARY 2022

Section 67 of LLP Act, gives power to Central Government to make certain provisions of Companies Act 2013 (Cos Act) applicable to LLP with or without exception, modification and adoption. Accordingly on 11 February 2022, Ministry of Corporate Affairs has made certain Sections of Cos Act like Section 90, 164, 165, 167, 206, 252 and 439 applicable to LLP with some modifications. With the modified version, these Sections of Cos Act are already applicable to LLP from 11 February 2022.

While adopting Section 90 of Cos Act for LLP, following changes have been made –

For the word “shares” wherever it occurs, the word “contribution” shall be substituted;

For the word “company” wherever it occurs, the words “limited liability partnership” shall be substituted;

For the word “member” wherever it occurs, the word “partner” shall be substituted;

For the word “officer” wherever it occurs, the words “partner” or “designated partner” shall be substituted

As a result of that Section 90 (1) reads as follows for LLPs–

(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 percent. or such other percentage as may be prescribed, in contribution of a limited liability partnership or the right to exercise, or the actual exercising of significant influence or control as defined in clause (27) of Section 2, over the limited liability partnership (herein referred to as “significant beneficial owner”), shall make a declaration to the limited liability partnership, 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.

There is no specific mention about applicability of Companies (Significant Beneficial Owners) Rules, 2018 (SBO Rules), however since Section 90 has been made applicable, it is presumed that corresponding rules will also become applicable with similar changes to LLPs.

NOTIFICATION DATED 27 OCTOBER 2023

Limited Liability Partnership Rules, 2009 (LLP Rules) have undergone amendment vide captioned notification and it has following important features –

1. Maintenance of Register of Partners with prescribed contents, timeline etc. became mandatory (Rule 22A)
2. Every person who does not hold beneficial interest in contribution needs to disclose who holds beneficial

interest in contribution to relevant LLP. Similar obligation is casted on person who holds beneficial interest but is not entered as partner in LLP. (Rule 22B)

3. Every LLP is mandated to disclose details received above to MCA and every LLP has to authorise one of designated partner to be responsible for these compliances. If no such designated partner is authorised, all designated partners shall be deemed to be responsible for this compliance. (Rule 22B)

All existing LLPs need to maintain Register of Partners within 30 days from commencement of notification dated 27 October 2023, i.e., by 26 November 2023. All partners who do not hold beneficial interest in contribution and the persons who holds beneficial interest but are not registered partners are required to make disclosure to the LLP within 30 days from the date on which the name of partners is entered in the Register of Members. Since such beneficial interest would have already been in existence as on commencement of this notification, it is recommended to make disclosure to the LLP within 30 days from 27 October 2023, i.e., by 26 November 2023. Thereafter all existing beneficial interest disclosures needs to be disclosed by LLP to MCA within 30 days from the receipt of disclosures. As mentioned earlier, this compliance has become applicable to all LLPs from 27 October 2023.

INTRICACIES ABOUT SBO/ BI PROVISIONS IN LLP ACT –

Partner and Partners transferable interest

Section 5 of LLP Act allows only individual and body corporate to be partners in LLP. Therefore, there is no possibility of any trust, HUF, pooled investment vehicle or partnership firm getting admitted as partner. It is only that if any individual or body corporate is acting as partner on their behalf then compliance of disclosure of beneficial interest or significant beneficial owner would trigger.

Further Section 42 of LLP Act recognises that interest / right of partner to receive profits or any other distribution is transferable while retaining his status as partner. And therefore, if there were any such situation, disclosure under Rule 22B of LLP Rules or Section 90 of Cos Act would trigger.

Beneficial Interest and Significant Beneficial Owner

Interestingly term beneficial interest is not defined in LLP Act, and definition mentioned in Section 89(10) of Cos Act has also not been expressly made applicable to LLPs. But intention appears that term beneficial interest mentioned in Section 89(10) of Cos Act would be applicable to LLPs with similar changes like those mentioned in Section 90. This indicates that, for the purpose of LLP, beneficial interest means –

Beneficial interest in contribution 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 –

1. Exercise or cause to exercise any or all the rights attached to such contribution; or
2. Receive or participate in any dividend or other distribution in respect of such contribution

As per combined reading of Section 89 and 90 (1) and definition of significant beneficial owner mentioned in rule 2(1)(h) of SBO Rules, significant beneficial owner in relation to LLP means an individual, 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 limited liability partnership, namely:

- (i) holds indirectly, or together with any direct holdings, not less than ten percent, of the contribution;
- (ii) holds indirectly, or together with any direct holdings, not less than ten percent, of the voting rights in the contribution;
- (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:

This adopted definition of ‘beneficial interest’ or ‘significant beneficial owner’ predominantly based on the presumption that:

- a. Contribution under LLP Act has similar characteristics features like term share/ share capital under Cos Act;
- b. The term ‘significant influence’ defined in rule 2(1)(h) of SBO Rules and term ‘control’ defined in Section 2(27) of Cos Act can be applied to LLP mutatis mutandis.

We will see how far this presumption is reliable.

One more point which we should keep in mind is, compliance of beneficial interest is not asking us to lift the corporate veil whereas SBO provision under Section 90 of Cos Act is expecting us to lift the corporate veil and see who the individual beneficial owner is. And therefore, compliances w.r.t. rule 22A or 22B of LLP Rules vs compliances arising out of 11 February 2022 is not same.

DISCLOSURE BASED ON CONTRIBUTION

Clause (i) of SBO definition says an individual who holds indirectly, or together with any direct holdings, not less than ten percent, of the contribution.

In LLP Act there is no requirement as to within how much time contribution committed in LLP agreement must be brought in by the partner. There are no provisions like Section 66 or 68 of Cos Act, which prescribes process if partner wants to withdraw contribution. And therefore,

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it is not necessary that contribution committed in LLP agreement will come in specified time period or will stay in LLP. Off course, if LLP is unable to pay debts to creditors, creditors can insist upon partner to bring in contribution committed in LLP Agreement¹.

And therefore, question that arises is how do you determine %? is it based on actual money/ equivalents contributed by the partner? or is it based on commitment made in LLP Agreement? Intention appears contribution committed in LLP Agreement should be the base.

VOTING RIGHT IN CONTRIBUTION

Clause (ii) for definition of Significant beneficial Owner refer ‘not less than ten percent, of the voting rights in the contribution.’

For determining who is significant or otherwise beneficial owner, Cos Act predominantly relies upon share capital as a base. Under Cos Act, by virtue of Section 47 voting is based upon paid up equity share capital held by a shareholder. In certain cases, if dividend is not paid on preference shares, even they would get voting right. This voting right is based on how much paid-up capital a shareholder holds.

Similarly, by virtue of Table F provisions of Cos Act, payment of dividend is in proportion to the paid-up share capital held by a shareholder. Whereas in case of LLP, there is no concept similar to shares or capital or voting or dividend.

In LLP there is concept of contribution. The term ‘contribution’ is not defined in LLP Act, however Section 33 LLP Act explains that creditors can enforce obligation of partner to contribute the amount which is mentioned in LLP Agreement. That means contribution is kind of a guarantee to the creditors that partners will pay this much value in LLP. Neither profit distribution nor voting is dependent upon contribution. Rather there is no concept of ordinary or special resolution in LLP. Even if a particular partner holds 99% contribution, it does not mean he has equivalent right of voting or profit drawal. There is no co relation. And therefore, contribution value may or may not be the indicator of control or ownership

¹ Section 33 (2) of LLP Act

or even influence. Therefore words “holds indirectly, or together with any direct holdings, not less than ten percent, of the voting rights in the contribution”² seems to be not serving the purpose, because there is no voting right in the contribution.

LLP Agreement is guiding document for decision making process as to how many partners consent will be required for a particular decision. If LLP Agreement is silent, provision of First Schedule to LLP becomes applicable³ and if First Schedule is also silent, it can be done only with consent of all the partners. In fact majority occasions, LLP Act either prescribes consent of all⁴ or majority partners⁵ and there is no co relation between decision making parameters and contribution. And therefore, reference of voting right and linking it to contribution does not seem to be relevant.

DIVIDEND / DISTRIBUTION OF PROFITS

Clause (iii) for definition of Significant beneficial Owner refer to right to receive or participate in not less than ten percent, of the total distributable dividend, or any other distribution, in a financial year through indirect holdings alone, or together with any direct holdings (shareholding).

This clause refers to right to receive not less than 10% dividend which is based on his shareholding. There is no concept of dividend in LLP. Cos Act prescribes process of declaration of dividend⁶ which is absent in LLP Act. Rights on profits of LLP will be dependent on LLP Agreement and if LLP Agreement is silent then every partner has equal right of profits⁷.

Words ‘any other distribution’ in clause (iii) also refers to right arising out of indirect or direct holdings in LLP. If this clause is suitably worded in context of LLP Act it will help.

As of now, we will have to go by LLP Agreement and if any individual has any indirect right (without being partner) to receive more than 10% profits of LLP, he should make disclosure.

REFERENCE OF SIGNIFICANT INFLUENCE OR CONTROL IN CONTEXT OF LLP

Clause (iv) of SBO definition says – any individual who has right to exercise, or actually exercises, significant influence or control, in any manner other than through direct-holdings alone.

Significant influence is defined at 2 places in Cos Act:-

Explanation to Sec 2(6) (definition of associate company)

The expression “significant influence” means control of at least twenty per cent. of total voting power, or control of or participation in business decisions under an agreement;

Another definition is in SBO Rules - Explanation VI in the Rule 2 (1) (h) - definition of SBO:-

“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. For ascertaining significant influence in context of SBO, we have to rely on this definition.

Similarly control is defined under Section 2(27) of Cos Act, which is –

“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.”

Difference between control and significant influence is as follows:

Particulars	Control	Significant influence
Right or power ⁸	Control is right.	Significant influence is power.
Is it about acting in concert (acting together)?	Yes, control can be alone or together with someone.	Doesn't appear to cover exercise of influence together with someone.
Is it via appointment of board?	Yes, right to appoint majority director is criteria to consider if there is control or not.	Significant influence does not cover right to appoint majority directors. But one may have right to appoint some Director(s).
Is it about policy making?	Control presupposes, if not right to appoint majority directors, a person should have control on management or policy.	Mere ability to participate in financial or operating policy decision will mean significant influence.

In case of LLP, there is no concept of Board of Directors. Rather there is no separation of management and ownership⁹. In LLP there is no shareholder/ director but there are partner and by default all partners have equal rights (unless otherwise agreed between partners

² Clause (ii) of Significant Beneficial Owner defined in sub rule 2(1)(h) of Companies (Significant Beneficial Owners) Rules 2018 as modified and adopted by MCA vide notification dated 11 February 2022 for LLP

³ Section 23 (4) of LLP Act

⁴ Shifting of Registered Office (Rule 17), Change of Name (Rule 20(1)), removal of auditor (Rule 24(18)), striking off name (Rule 37) etc. of LLP Rules 2009

⁵ Point no. 8 of Schedule I of LLP Act

⁶ Chapter VIII of Cos Act

⁷ Point no.2 in First Schedule to LLP Act

⁸ Generally right is inherent for example fundamental rights, and powers are bestowed by someone like power of director are only till the time he is on the Board.

⁹ LLP is essentially a partnership



via LLP Agreement). And therefore, ability to appoint majority director is not relevant for determination of having control. And by default, every partner has a right to participate in policy decision making process and therefore irrespective of any contribution, right to profit or otherwise, every partner has joint control along with other partners on affairs of LLP. And therefore, if body corporate is acting as partner in LLP, disclosure of SBO will be necessary irrespective of what is contribution and what is profit right of that corporate partner in LLP.

If LLP Agreement provides that some partner(s) has all rights to take all decisions and other partner(s) have no rights, then it needs to be evaluated whether SBO disclosure is required for such corporate partner who does not have right to participate in decision making process.

WHAT IS THE COMPLIANCE REQUIREMENT UNDER RULE 22B WITH RESPECT TO BENEFICIAL INTEREST DISCLOSURES?

Latest notification of 27 October 2023 of MCA is expecting every LLP to disclose if any partner is not beneficially interested or is beneficially interested but not acting as partner. There are forms prescribed for these disclosures. Some examples where this disclosure will trigger are –

- (a) LLP which is formed by corporate and for the compliance of minimum 2 partners some director or officer is admitted as partner but beneficial interest is of the corporate on whose behalf he holds economic interest.
- (b) With respect LLPs where trustee acts partner in LLP on behalf of beneficiaries, trustee and beneficiary can make disclosure in the prescribed form arising out of Rule 22B.

- (c) If Karta is acting as partner on behalf of HUF in LLP, Karta of HUF can make disclosure about his nominee status in relevant form.

In any LLP, if a body corporate is holding partner status, whether we need to look at who has majority stake in such body corporate and make disclosure under rule 22B? Corporate entity is a separate legal entity and that corporate entity has beneficial interest in wherever they invest and act as partner. Section 90 of Cos Act would deal with such situations and there would be disclosure requirements. However, for that purpose E-forms BEN 1,2,3,4 needs to be tweaked to take care of LLP structure. Though Section 90 has been made applicable to LLP from 11 February 2022 and SBO will have to make disclosure to LLP and then LLP to MCA, there is no enabling E-form for it. Current amendment of 27 October 2023 is about disclosure of beneficial interest and not about significant beneficial owner.

CONCLUSION

Disclosure of beneficial interest and significant beneficial owner are subject of national interest and every corporate or professional has to comply with it, otherwise there are serious consequences. While it is very clear that these compliances have been made applicable to LLP, these rules need to be overhauled looking at nuances of LLP eg. LLP does not have separation of management and ownership, LLP does not have concept of share capital or voting or dividend, LLP does not have concept of voting like companies it is rather partnership, LLP does not allow anyone to become partner apart from individual or body corporate. Compliance professional can look at the intent of regulator and try to comply looking at the intent. At the same time, to avoid any confusion in minds of stakeholders, MCA may come out with specific framework [rules and E-forms] with respect to SBO for LLP at the earliest.

