

IDENTIFYING SIGNIFICANT BENEFICIAL OWNERS

Why lifting corporate veil may not be easy

SUDIPTO DEY

The Companies (Amendment) Bill, 2019, has cast specific responsibility on companies to identify significant beneficial owners (SBOs) as part of measures to strengthen the governance framework for businesses.

While this is not a new provision — a similar provision was included by the amendment to the SBO Rules in February 2019 — earlier there were no corresponding penalty provisions for non-compliance. Also, the latest amendment puts the onus on the company to take “necessary steps” to identify an SBO.

“The object is very clear that an individual needs to be identified who is the significant beneficial owner of the company. The companies should implement the Rules in spirit, and not only in letter of law,” says Lalit Kumar, partner, J Sagar Associates.

According to Sampath K Rajagopalan, partner, entity compliance and governance, EY India, the introduction of penalties on firms for failure to take adequate steps to identify their SBOs and make them report underscores the importance of this responsibility.

“Companies must initiate enquiries wherever the facts are unclear or unknown, review all such facts in detail and prudently interpret the qualifying conditions before concluding on their SBOs,” he says. Tests must be run up to the level of ultimate shareholding in the investment structure.

However, that is easier said than done. In

WHO IS AN SBO

An individual who alone, or together, or through one or more persons/trust, holds one or more of the following rights/entitlements in the reporting company:

- Directly or indirectly 10% of the shares
- Directly or indirectly 10% of the voting rights
- The right to participate in 10% of distributable dividends or any other distribution during the financial year, whether directly or indirectly
- The right to exercise significant influence or control, in any manner other than via direct-holdings alone



some complex shareholding pattern, a company may not be aware of the shareholder's shareholding. “All this will ultimately give rise to litigation,” says Gaurav Pingle, a practising company secretary.

If the SBO does not provide the necessary information or gives inadequate information, the company could apply to the National Company Law Tribunal (NCLT) for putting restrictions concerning the transfer of interest

and suspension of rights attached to the shares.

According to experts, there could be implementation challenges in the identification of an SBO, defining ‘indirect shareholding’ of an individual, and identifying ‘majority stake’.

For instance, “acting together” is defined in the Bill, but could be difficult to interpret and apply. “Acting together focuses on the intent and the objective of two or more persons to

control the company,” says Pingle. Experts complain the SBO rules do not provide for a mechanism for identification of an SBO.

Kumar points out that the concept of “significant influence” is not very clear. “It says anyone who has the power to participate in the financial and operating policy decision. The concept of participation is not clear because by mere participating, it would mean the person has a significant influence. This needs some clarity,” he adds.

Arnav Dayal, partner, Trilegal, says there is ambiguity around what constitutes “necessary steps”. According to the existing provisions, the reporting company is already obligated to issue a notice to a person whom it believes is an SBO.

“Post the amendment, if a reporting company is expected to go over and above these requirements, then guidance should be provided on the actions expected to be undertaken,” he adds. Experts say a few definitions are open for interpretation as some firms have complex shareholder structures.

Under the amendment, for non-compliance, the company, and every officer of the company in default is punishable with a fine of between ₹10 lakh and ₹50 lakh (continuing failures attract an additional fine of ₹1,000 per day of default). The Bill also prescribes other penalty provisions for the failure of an SBO to make a declaration with the reporting company.

However, experts note that the commencement date of the penalty provision has not been notified yet.