

Substance and Significance of Beneficial Ownership Provisions

This article focuses on the substantive provisions relating to the declaration of beneficial ownership in a company.

Sections 89 and 90 of the Companies Act, 2013 (Act) deal with ascertaining the beneficial owner of the shares held in a company and disclosures in relation thereto. Both sections are applicable to all companies.

Beneficial Ownership Provisions

Section 89 deals with the declaration with respect to a beneficial interest in any share. Section 89 of the Act requires a person to make disclosure where his name is entered in the register of company members as the holder of shares but who does not hold a beneficial interest in such shares. Such a person is required to give disclosure in the prescribed format to the company, specifying the name and other particulars of the person who holds the beneficial interest in such shares.

The said section also requires a person who is the beneficial owner but not the legal owner to make a declaration to the company. The declaration in the prescribed form should specify the nature of interest held by the beneficial owner, the particulars of a person who is a legal owner, etc.

It is to be noted that both the legal owner and beneficial owner must declare to the company in a prescribed format.

Sub-section (10) of Section 89 of the Act defines beneficial owner in an inclusive manner that 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:

- exercise or cause to be exercised any or all the rights attached to such share; or
- receive or participate in any dividend or other distribution with respect to such share.

Thus, the above definition envisages two persons, one who is a legal owner of the share and another who has the right or entitlement to deal with such share through any contract, arrangement or otherwise.



Significant Beneficial Owners (SBO) in a company

Section 90 deals with provisions related to SBO and was originally enacted by the Companies Act 2013. It was replaced by the Companies (Amendment) Act 2017 and the amended section was made effective from 13 June 2018. Simultaneously, Companies (Significant Beneficial Owners) Rules, 2018 (Rules) were notified on 13 June 2018.

Provisions relating to SBO seek to identify the individual (whether Indian or foreign resident) who holds a beneficial interest of 25% or such other percentage as may be prescribed in the shares of the company. The Rule lowered the threshold of shareholding to 10% from 25%. Apart from the percentage criteria, there is a subjective test also wherein the individual shall be considered as SBO where he has the right to exercise or the actual exercising of significant influence¹ or control over the company in any manner.

As per Rules SBO 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, possess one or more of the following rights or entitlements in such reporting company:

- holds indirectly, or together with any direct holdings, not less than 10% of the shares;
- holds indirectly, or together with any direct holdings, not less than 10% of the voting rights in the shares;
- has the right to receive or participate in not less than 10% ten of the total distributable dividend, or any other distribution, in a financial year through indirect holdings alone or together with any direct holdings;
- has the right to exercise, or actually exercises, significant influence or control, in any manner other than through direct holding alone.

It is clarified that if an individual does not hold a right or entitlement indirectly under (i) to (iii) above, then he shall not be considered as an SBO.

Only direct holdings are excluded from the provisions of SBO. Direct holding is clarified where the individual is holding an investment in his name directly or he is holding beneficial interest in such shares and a declaration to that effect is reported to the company.

Indirect holding

The objective of SBO is to reach out to the natural person who ultimately holds a significant beneficial interest in the company. SBO is an extension of provisions of the beneficial owner as envisaged in Section 89 and is wider in application than that. Therefore, the Rules prescribe the criteria by which an individual would be deemed to hold the rights and entitlements indirectly. The criteria of indirect holding is explained in the Rules as follows, where a member of the reporting company:

Sr. No.	Nature of entity	Who shall be considered SBO
1	is a body corporate (whether incorporated in India or abroad) other than a limited liability partnership	and the individual: <ul style="list-style-type: none"> • holds a majority stake in that member body corporate; • holds a majority stake in the ultimate holding company of the body corporate.

1. "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.



Sr. No.	Nature of entity	Who shall be considered SBO
2	is a Hindu Undivided Family (HUF) (through karta)	the individual karta of the HUF.
3	is a partnership firm (through itself or a partner)	and the individual: <ul style="list-style-type: none"> • is a partner; or • holds a majority stake in the body corporate, which is a partner of the partnership entity; or • holds a majority stake in the ultimate holding company of the body corporate, which is a partner of a partnership entity.
4	a trust (through trustee)	and the individual: <ul style="list-style-type: none"> • is a trustee in the case of a discretionary trust or a charitable trust; • is a beneficiary in the case of a specific trust; • is the author or settlor in case of a revocable trust.
5	is (a) a pooled investment vehicle; or (ii) an entity controlled by the pooled investment vehicle [based in a member state of 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, and the individual in relation to the pooled investment vehicle]	individual in relation to the pooled investment vehicle: <ul style="list-style-type: none"> • is a general partner; or • is an investment manager; or • is a CEO where the investment manager of such pooled vehicle is a body corporate or a partnership entity.
6	is (a) a pooled investment vehicle; or (ii) an entity controlled by the pooled investment vehicle [based in jurisdiction which does not fulfil the requirement referred in (v) above]	As per provisions of (i) to (iv) of the above.

Acting together

As noted above, both Section 90(1) and Rule 2(1)(h) require that the determination of SBO an individual referred to in Section 90(1) must be on the basis of such individual acting alone, together or through any other person(s) or trust(s).

Acting together means acting in concert, in unison, in association, business, or agreement, jointly, in collaboration, plan or design as a group or association with a common purpose or objective. Whether two persons act together will have to be decided not only by a written agreement or any other document but also by having regard to circumstances concerning their actions.



The Explanation V appended to the definition of “significant beneficial owner” explains the term “acting together” as under:

- “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.’”

The following are the ingredients of “acting together”:

- an individual or individuals act through any person or trust;
- in acting through, he/they have common intent or purpose of exercising any rights or entitlements, or exercising control or significant influence, over the reporting company;
- he/they act pursuant to an agreement or understanding;
- such agreement or understanding is formal or informal.

Significant Influence

Another criterion to ascertain SBO is an individual who has the right to exercise or actually exercises significant influence or control in any manner. According to Rule 2(1)(i) of the SBO Rules, ‘significant influence’ means the power to participate, directly or indirectly, in the reporting company’s financial and operating policy decisions but is not control or joint control of those policies.

This definition is hard to interpret and apply. The word ‘power’ is crucial in this definition. It is not defined. One of the several meanings in dictionaries is: ‘possession of control, authority, or influence over others; legal ability, capacity, or authority’ seems to be apt in the context of the provision in Rule 2(1)(h)(iv).

Thus, to fall within the ambit of the definition of “significant influence,” there must exist power to participate in the company’s financial and operating policy decisions, regardless of whether it is actually exercised. Therefore, if an individual (acting alone or together with other individual(s)) has the power to participate (directly or indirectly) in the financial and operating policy decisions of the company, he will be considered an individual having significant influence and consequently a significant beneficial owner.

In a company, policy decisions are made by the Board of Directors and are implemented by the executive directors and other officers of the company. Section 179(1) of the Act provides that the Board of Directors of a company shall be entitled to exercise all such powers and to do all such acts and things as the company is authorized to exercise and do.

The Board makes financial and operating policy decisions. Therefore, under clause (iv) of Rule 2(1)(h), if an individual who is not a member of the Board but has the power to participate, directly or indirectly, in the financial and operating policy decisions of the reporting company, he will be deemed to be having the right to exercise significant influence. This will undoubtedly need some evidence in the form of an agreement (such as a shareholders’ agreement) or, articles of association, or some other document that entrusts such individual the power to participate, directly or indirectly, in the company’s financial and operating policy decisions.



Control

Other limb of the SBO definition is a person who has the right to exercise or actually exercise control in any manner. The word 'control' in Rule 2(1)(h)(iv) is to be understood according to the definition given in Section 2(27) of the Act. That definition reads as follows:

“‘control’ shall include the right to appoint a 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.”

The definition is an inclusive definition; in addition to what it states, it would apply to anything that can be said to be controlled in the ordinary sense of the term in the context of the provisions of the Act;

The following situations would lead to the presumption that there exists control over a person:

- Such a person has the right to appoint a majority of the directors of the company; or
- Such a person controls the management or policy decisions in relation to the company.
- Control may be exercisable by one person acting individually or more persons than one acting in concert;
- Control may be direct or indirect;
- Control may be by virtue of or in the form of:
 - Shareholding in the company; or
 - Management rights in relation to the company; or
 - Shareholders' agreement; or
 - Voting agreement; or
 - In any other manner.

In the context of working of companies, in law, control is undertaken as majority control or, in other words, control by virtue of shareholding or voting power, which determines, in the ultimate analysis, the power to control a company. In other words, normally, control over a company means exercise of power by voting rights, and a person or a group is said to have controlling interest if he or she has power by exercise of voting rights to carry a resolution at a general meeting.

It is not uncommon to come across instances of de facto control in the corporate world being exercised by a group of people holding a small proportion of capital since it is well-recognized that a majority holding of shares is not essential, nor is that always the decisive factor in determining effective or actual control over a company by a few. Such real or de facto control can be had in many ways. It is well known that in a company with a large and dispersed shareholding, a comparatively small proportion of the total shares, if held by a few hands, may enable actual control to be exercised.

In common parlance, a person is said to have a “controlling interest” in a company when such a person acquires, by purchase or otherwise, the majority of the vote-carrying shares in that company, for the control of the company, resides in the voting powers of its shareholders. In this sense, the directors of a company may well be regarded as having “a controlling interest” in the company when they hold and are entered in the share register as holders of the majority of the shares which, under the articles of association of the company, carry the right to vote².

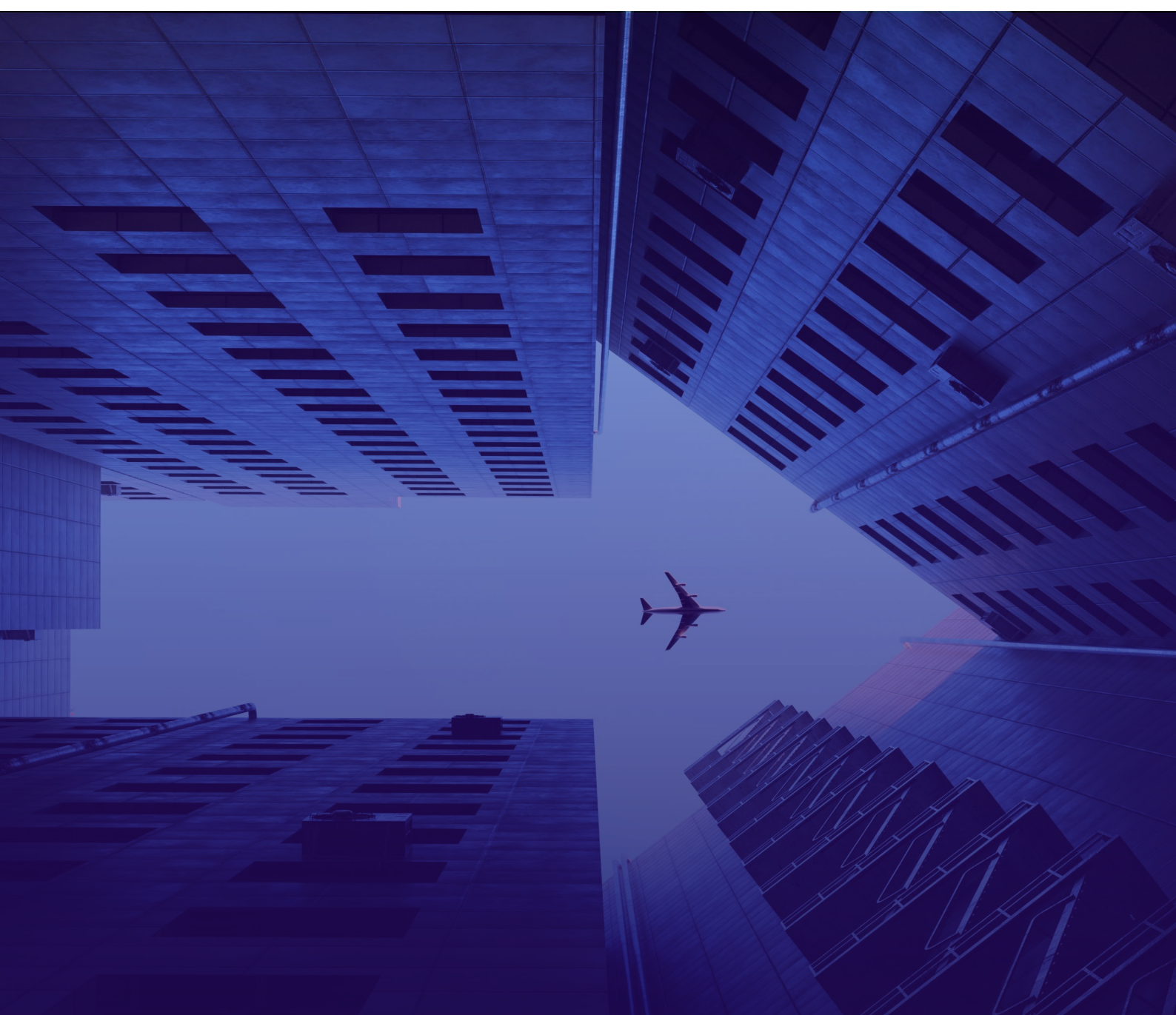
2. Glasgow Expanded Metal Co. Ltd Commissioners of Inland Revenue and Commissioner of Inland Revenue v. B W Noble, (1926) 12 Tax Cas 911].



It is not, however, necessary that to have “a controlling interest,” the person or persons who hold the majority of the vote-carrying shares must have a beneficial interest in the shares they hold. These persons may hold the shares as trustees and may even be accountable to their beneficiaries and may be brought to book for exercising their votes in breach of trust, nevertheless, as between them as shareholders and the company, they are the shareholders, and as such, have “a controlling interest” in the company, they are the shareholders, and as such have “a controlling interest” in the company³.

Conclusion

Although the provisions related to significant beneficial owner appear on a smaller scale, they have wide reporting ramifications. Therefore, it is important to understand and identify the significant beneficial owner in relation to a company considering the onerous obligations cast on companies and individuals to ensure the compliance is followed as prescribed under the Act.



3. Commissioner of Income-tax, West Bengal v. Jeewanlal Ltd. AIR 1953 SC 473; see also Inland Revenue Commissioners v. J. Bibby and Sons Ltd., (1946) 14 ITR (Suppl) 7:(1945) 1 All ER 667:29 Tax Cas 167; Commissioner of Income-tax v. Bipin Silk Mills AIR 1947 Bom 45.



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