

Beneficial Ownership: A Comparative Analysis

1. INTRODUCTION

- 1.1. Under changes to India's foreign direct investment regulations (the "**FDI Regulations**") with effect from April 22, 2020, (i) an investment by entities of a country which shares a land border with India or where the beneficial owner of an investment into India is situated in or is a citizen of any such country; and (ii) any transfer of ownership of any existing or future foreign direct investment in an entity in India, directly or indirectly, resulting in the beneficial ownership falling within this restriction, requires the prior approval of the Government of India (the "**2020 FDI Amendment**").
- 1.2. Effectively, investments from seven countries, including China, are impacted as there may be a delay in obtaining regulatory approval (or the investment may be rejected). These changes to the FDI Regulations require an assessment of, among other issues, the term "*beneficial owner*". Although the Government issued an updated version of the FDI Regulations effective from October 15, 2020, these do not clarify the manner of determination of a "*beneficial owner*". This term has been defined under other Indian laws, although a uniform definition is not available.
- 1.3. This note focuses on the scope and definition of "*beneficial ownership*" under certain Indian laws as well as the definition in the United Kingdom ("**U.K.**") and the United States of America (the "**U.S.**"). It does not provide an exhaustive description of disclosure and other compliance requirements relating to beneficial ownership.

2. INDIA

2.1. Companies Act, 2013

- 2.1.1. Under the Companies Act, 2013, as amended (the "**Companies Act**") and the Companies (Significant Beneficial Owners) Rules, 2018, as amended, (the "**SBO Rules**"), a "*significant beneficial owner*" in relation to an Indian company (a "**Company**") is defined as any individual who, acting alone or together or through

one or more persons or trust,¹ possesses one or more of the following ‘rights or entitlements’ in the Company:

- (i) holds, indirectly or together with any direct holdings, not less than 10% of the shares or voting rights (the term “*shares*” includes compulsorily convertible preference shares, compulsorily convertible debentures and global depository receipts);
- (ii) has the right to receive or participate in not less than 10% of the total distributable dividend or any other distribution in a financial year through indirect holdings alone,² or together with any direct holdings; or
- (iii) has the right to exercise or actually exercises, significant influence or control, in any manner other than through direct holdings alone.

The term “*control*” includes 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.

The term “*significant influence*” is defined as the power to participate, directly or indirectly, in the financial and operating policy decisions of a company but does not include control or joint control of those policies.

These terms are open for interpretation, as it is not clear which rights or provisions in a contract constitute control over the management or policy decisions of an entity. This has neither been clarified by the regulators nor has the interpretation by the courts been helpful in reaching a consensus.

2.1.2. The SBO Rules are not applicable to the extent the shares of the Company are held by specified entities such as the Indian federal or state government, investment vehicles registered with the Securities and Exchange Board of India (the “**SEBI**”) (such as mutual funds, alternative investment funds, real estate investment trusts and infrastructure investment trusts) and investment vehicles regulated by the Reserve Bank of India (the “**RBI**”), the Insurance Regulatory and Development Authority of India or the Pension Fund Regulatory and Development Authority.

2.1.3. Under the SBO Rules, an individual is considered to hold a ‘right or entitlement’ directly in the Company if (i) the shares representing such right or entitlement are

¹ If any individual(s) 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(s), acting through any person or trust, as the case may be, shall be deemed to be “acting together” (*Explanation V to Rule 2(1)(h) of the SBO Rules*).

² Note that if an individual does not hold any right or entitlement indirectly under (i) or (ii) above, such individual shall not be considered to be a significant beneficial owner (*Explanation I to Rule 2(1)(h) of the SBO Rules*).

held in the name of such individual; or (ii) the individual holds or acquires beneficial interest in the shares (e.g., the right to receive dividends and/or exercise all rights relating to such shares) and has made the relevant declarations under the Companies Act in this regard to the Company.

2.1.4. An individual is considered to hold a 'right or entitlement' *indirectly*, if such individual satisfies any of the criteria specified in the Companies Act in respect of any shareholder of the Company, which include the following:

- (i) where such shareholder is a corporate entity (whether incorporated in India or abroad), and the individual holds majority stake³ in either such shareholder or in the ultimate holding company (whether incorporated in India or abroad) of such shareholder;
- (ii) where such shareholder is a partnership entity (through itself or a partner), and the individual:
 - a. is a partner;
 - b. holds majority stake in a body corporate which is a partner of the shareholder; or
 - c. holds majority stake in the ultimate holding company of a body corporate which is a partner of the shareholder;
- (iii) where such shareholder is a trust (through a trustee), and the individual:
 - a. is a trustee in case of a discretionary trust or a charitable trust;
 - b. is a beneficiary in case of a specific trust; or
 - c. is the author or settlor in case of a revocable trust; and
- (iv) where such shareholder is a pooled investment vehicle or an entity controlled by a pooled investment vehicle based in a member State of the Financial Action Task Force, 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, is:
 - a. a general partner;
 - 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.⁴

³ "Majority stake" means (i) holding more than one-half of the equity share capital in the body corporate; (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 (*Rule 2(1)(d) of the SBO Rules*).

⁴ In the event the pooled investment vehicle or the entity controlled by a pooled investment vehicle does not meet the jurisdictional threshold prescribed in paragraph 2.1.3(iv) above, the provisions of paragraph 2.1.3(i), (ii) or (iii) shall apply accordingly (*Explanation IV to Rule 2(1)(h) of the SBO Rules*).

2.2. Prevention of Money-laundering Act, 2002

2.2.1. Under the Prevention of Money-laundering Act, 2002, as amended (the “**PML Act**”), “*beneficial owner*” means an individual who ultimately owns or controls a person⁵ who is engaged in a financial transaction or activity with a reporting entity (*i.e.*, banking company, financial institution, intermediary or a person carrying on a designated business or profession under the PML Act) or the person on whose behalf a transaction is being conducted and includes a person who exercises ultimate effective control over a juridical person.

2.2.2. The Prevention of Money-laundering (Maintenance of Records) Rules, 2005, as amended (the “**PML Rules**”) define “*control*” to include the right to appoint majority of the directors or to control the management or policy decisions, including by virtue of shareholding or management rights or shareholders agreements or voting agreements.

2.2.3. Further, the PML Rules prescribe the following tests for identification of beneficial owner(s):

- (i) In case of a company: the beneficial owner is/are the natural person(s) who (whether acting alone or together or through one or more juridical persons) has a controlling ownership interest (more than 25%) or who exercises control through other means;⁶
- (ii) In case of a partnership firm, unincorporated association or body of individuals: the threshold for determination of the beneficial owner is ownership of/entitlement to more than 15% of capital or profits of the relevant partnership firm and 15% of the property or capital or profits of the unincorporated association or body of individuals, respectively;⁷
- (iii) In case of a trust: the identification of the beneficial owner includes identification of the author of the trust, the trustee, beneficiaries with 15% or more interest in the trust and any other natural person exercising ultimate effective control over the trust through a chain of control or ownership; and
- (iv) In case of (or where the owner of the controlling interest is) an entity listed on a stock exchange in India, or an entity listed on a stock exchange in a jurisdiction notified by the Indian Government, or a subsidiary of such listed entities, it is

⁵ A person includes, *inter-alia*, an individual, a company, a firm, an association of persons or a body of individuals and any agency, office or branch owned or controlled by any of the aforementioned entities (*Section 2(s) of the PML Act*).

⁶ “Controlling ownership interest” means ownership of/entitlement to more than 25% of the shares or capital or profits of the company (*Rule 9(3) of the PML Rules*).

⁷ In the event no natural person is identified as the beneficial owner of a company, partnership firm, unincorporated association or body of persons, the beneficial owner shall be the relevant natural person who holds the position of senior managing official (*Rule 9(3)(d) of the PML Rules*).

not necessary to identify and verify the identity of any shareholder or beneficial owner.

2.2.4. The RBI's Master Direction on Know Your Customer (KYC) Direction, 2016 dated February 25, 2016 and the RBI's Master Circular on "Know Your Customer (KYC) norms/Anti-Money Laundering (AML) standards/Combating Financing of Terrorism (CFT)/Obligation of banks and financial institutions under the PML Act" dated July 1, 2015, each as amended from time to time, require the identification of beneficial owners of regulated entities pursuant to the tests mentioned in paragraph 2.2.3 above.

2.3. Securities Laws

2.3.1. Intermediaries registered with the SEBI are required to identify beneficial owners of clients (such as foreign portfolio investors that seek to open custodian accounts and entities that seek to open depository accounts) at the time of opening securities accounts. Under the applicable guidelines, a beneficial owner is a natural person(s) who ultimately owns, controls or influences a client and/or persons on whose behalf a transaction is being conducted; such beneficial owner could also include those persons who exercise ultimate effective control over a legal person or arrangement. The tests for identification of such beneficial owners are similar to those in paragraph 2.2.3 above.

2.3.2. For purposes of disclosures in offer documents such as an IPO prospectus, the SEBI requires the issuer company to confirm that such issuer company, its promoters, promoter group and selling shareholders, if any, are in compliance with the SBO Rules. Pursuant to circulars issued under the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, a listed company to which the SBO Rules apply is required to disclose details in relation to its significant beneficial owners (including nationality) in a format prescribed by the SEBI to the stock exchanges on a periodic basis.

2.4. Ministry of Finance

2.4.1. In July 2020, the Public Procurement Division, Department of Expenditure of the Ministry of Finance issued an order specifying conditions for bidders from countries sharing a land border with India. The term "*bidder from a country which shares a land border with India*" and "*beneficial owner*" are defined in such order, and the tests for identification of beneficial owners are similar to those in the PML Rules, as set out in paragraph 2.2.3 above.

3. UNITED KINGDOM

- 3.1. The [U.K.] Companies Act, 2006 requires, *inter-alia*, companies incorporated in the U.K. to maintain a register disclosing the identity of person(s) who have significant control (“PSC”) over such entity as well as the “*relevant legal entities*” (“RLE”) who meet the “*registrable*” criteria specified therein.
- 3.2. A PSC is an individual (and not a legal entity such as a company or a limited liability partnership) who meets any one or more of the following conditions in relation to a company:⁸
- (i) directly or indirectly⁹ holds more than 25% of the shares or voting rights;
 - (ii) directly or indirectly holds the right to appoint or remove majority of the directors/managers or the equivalent management/supervisory body;
 - (iii) otherwise has the right to exercise, or actually exercises significant influence or control;¹⁰ or
 - (iv) has the right to exercise, or actually exercises, significant influence or control over the activities of a trust or a firm which is not a legal entity,¹¹ but would itself satisfy any of the conditions from (i) to (iii) above if it were an individual.

An RLE is a legal entity which would have come within the definition of PSC had it been an individual and is subject to its own disclosure requirements as specified under the [U.K.] Companies Act, 2006.

4. UNITED STATES

- 4.1. In the U.S., for listed companies, beneficial ownership is required to be disclosed if the shareholders own more than 5% of the outstanding securities. Each state has its own corporation laws and many U.S. states do not collect, verify or update information on “*beneficial ownership*” of corporations. Also, at the federal level, the Customer Due Diligence Rules clarify and strengthen customer due diligence

⁸ It is possible for a company to have no PSCs or multiple PSCs.

⁹ By virtue of holding shares through a nominee, jointly with another person or having joint arrangements with another person in relation to exercise of rights.

¹⁰ A company is required to identify whether a PSC or an RLE meets this condition only if they do not meet conditions at (i) to (ii). According to the relevant Statutory Guidance issued by the Department of Business, Energy and Industrial Strategy, for determining “significant influence or control”, all relationships that a person has with the company or other individuals who have management responsibility of the company should be taken into account to identify whether the cumulative effect of such relationships places the person in a position where they actually exercise significant influence or control.

¹¹ The relevant Statutory Guidance issued by the Department of Business, Energy and Industrial Strategy provides a non-exhaustive list of persons who would not, merely by occupying such role, be considered to exercise “significant influence or control” over the trust or firm. These roles include an accountant investment manager, tax or financial advisor, lawyer, management consultant, a lender, a regulator, a liquidator or receiver.

requirements for, *inter-alia*, banks and mutual funds and help identify the beneficial ownership structures.

4.2. U.S. Securities Laws

4.2.1. For a U.S. company that has registered a class of its equity securities under section 12 of the [U.S.] Securities Exchange Act of 1934 (the “**SEC Act**”) or meets other specified criteria, shareholders who beneficially own more than 5% of the outstanding securities of that class must file beneficial owner reports in Schedule 13D or 13G until their holdings drop below 5%. The [U.S.] Williams Act of 1968 (the “**Williams Act**”) had amended the SEC Act to include section 13(d) in the SEC Act “...*in response to the growing use of cash tender offers as a means for achieving corporate takeovers*” – this was enacted to address a gap in securities laws and require disclosure when securities holders began “*accumulating large blocks of equity securities of publicly held companies*”.

4.2.2. Further, Section 16 of the SEC Act requires directors and officers of a company that has a class of securities registered under Section 12 of the SEC Act as well as persons who beneficially own more than 10% of any class of equity securities (other than an exempted security) which is registered under Section 12 of the SEC Act, to file reports with the [U.S.] Securities and Exchange Commission in prescribed formats.

4.2.3. Under U.S. securities laws, a “*beneficial owner*” of a security includes any person who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise has or shares either (i) voting power which includes the power to vote, or to direct the voting of such security; and/or (ii) investment power which includes the power to dispose, or to direct disposition of, such entity.

Under each of the [U.S.] Securities Act of 1933 and the SEC Act, the term “*control*” means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract or otherwise. This is not a bright-line test and depends on the facts and circumstances of the case.

4.3. Banking and FATCA Rules

4.3.1. Pursuant to the [U.S.] Bank Secrecy Act of 1970, the [U.S.] Financial Crimes Enforcement Network (the “**FinCEN**”) issued the Customer Due Diligence Rules (the “**CDD Rules**”) pursuant to which certain financial institutions such as banks, mutual funds and securities brokers must establish and maintain written procedures that are reasonably designed to identify and verify the “*beneficial owners*” of legal entity customers (“**LECs**”) such as corporations, limited liability companies, general

partnerships and similar entities formed under foreign laws, that open new accounts from May 2018.¹²

4.3.2. Under the CDD Rules, a “*beneficial owner*” means:

- (i) an individual who, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise, owns 25% or more of the equity interests of an LEC;
- (ii) an individual with significant responsibility to control, manage, or direct an LEC, including an executive officer or senior manager, or any other individual who regularly performs similar functions; or
- (iii) the trustee, where a trust owns directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise, 25% or more of the equity interests of an LEC.

4.3.3. At least one person is required to be identified under the control test (in paragraph 4.3.2(ii) above) and zero to four individuals can be identified under the ownership test (in paragraphs 4.3.2(i) and (iii) above) – accordingly, an LEC will have a total of between one and five beneficial owner(s). Identification of a beneficial owner under the ownership tests above is not required if no individual owns 25% or more of an LEC.

4.3.4. The Corporate Transparency Act, 2019 (the “**Bill**”), if enacted into law, would require newly formed and certain existing corporations and limited liability companies to report to the FinCEN, on an ongoing basis, the identities of their “*beneficial owners*”. Under the Bill, subject to certain exceptions, a “*beneficial owner*” is defined as a natural person who, directly or indirectly:

- (i) exercises substantial control over the corporation or company;
- (ii) owns 25% or more of the equity interest of the corporation or company; or
- (iii) receives substantial economic benefits from the assets of the corporation or company (this will be linked to a specified percentage of the funds or assets of the corporation or limited liability company to be notified by the Secretary of the Treasury).

4.3.5. For the purpose of combating tax evasion, the [U.S.] Foreign Account Tax Compliance Act requires certain foreign financial institutions to disclose information

¹² Certain entities such as investment companies registered with the [U.S.] Securities and Exchange Commission, investment advisors, pooled investment vehicles operated by financial institutions excluded under the CDD Rules and foreign financial institutions established in a jurisdiction where the regulator of such institution maintains beneficial ownership information regarding such institution are not considered as LECs and do not fall under the ambit of the CDD Rules.

when, *inter-alia*, U.S. persons hold a substantial ownership interest (more than 10%) in their customers.¹³

5. CONCLUSION

- 5.1.1. Since April 22, 2020, the threshold for requirement for prior government approval under the 2020 FDI Amendment has remained unclear and can arguably be triggered even if a single share of an investing entity is beneficially held by an investor from one of the restricted bordering countries. The updated FDI Regulations, effective as of October 15, 2020, also do not provide any guidance. This has created uncertainty not only regarding inflow of new investments from China in the start-up sector but also regarding investments of private equity funds which may have investments from Chinese limited partnerships. As reported by the Indian media, the confusion is further fueled by China's opaque beneficial structures with little demarcation between private and state control.
- 5.1.2. While other Indian laws prescribe certain tests for "*beneficial ownership*", these are not consistent. For example, although "*control*" under each of the Companies Act and the PML Rules is defined in a similar and subjective fashion, "*controlling ownership interest*" under the PML Rules and "*significant beneficial ownership*" under the SBO Rules refer to ownership thresholds of 25% and 10%, respectively. As discussed above, the term "*control*" is subjective as it relates to the control over the "*management and policy decisions*" of a company, which, in the absence of definitive guidance, is open to interpretation on a case-by-case basis.
- 5.1.3. As a practical matter, authorised dealer banks, which deal in foreign exchange and oversee reporting of foreign investment transactions, have either applied varying numerical thresholds or have sought a blanket confirmation of compliance with the 2020 FDI Amendment (i.e., without any threshold).
- 5.1.4. In both the U.S. and the U.K., an objective ownership threshold of 25% is applied to determine an individual beneficial owner, and subjective tests of significant influence/control are also applied. In the U.S., lower ownership thresholds of 5% or 10% are applied for specific purposes such as to elicit disclosure in respect of listed companies or for purposes of detection of tax evasion.
- 5.1.5. In the Indian context, if an ownership threshold of less than 25% is applied in the context of the FDI Policy, along with a subjective test (e.g., relating to control), this is likely to significantly increase the number of cases that will require prior regulatory approval under the 2020 FDI Amendment. While previous Indian media reports suggested that the Government planned to accelerate the FDI approval

¹³ Defined to mean ownership, directly or indirectly, of more than 10% of the stock (by vote or value) of a foreign corporation or of the interests (in terms of profits or capital) of a foreign partnership; or, in the case of a trust, the owner of any portion of it or the holder, directly or indirectly, of more than 10% of its beneficial interest.

process for cases arising from the 2020 FDI Amendment, news reports in October 2020 suggest that the Government may issue guidelines for beneficial ownership without any floor or threshold.

As a practical matter, the FDI approval process under the current regime (where the sectoral ministry is the relevant authority) has been more time-consuming than it was under the erstwhile Foreign Investment Promotion Board, which was abolished three years ago and hence, urgently requires to be streamlined to remove inefficiencies. Therefore, it remains to be seen whether the Government will be able to effectively balance the implementation of the 2020 FDI Amendment with the funding and other requirements of Indian-incorporated entities. The Government should consider setting up a pre-filing consultation mechanism, similar to the Competition Commission of India, to facilitate early determination of an approval requirement and reduce its administrative burden. It should also consider undertaking fast-track review of FDI applications in most sectors barring identified sensitive sectors such as critical infrastructure, banking, health care and telecom.

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