UNVEILING THE COMPLEX WEB OF CORPORATE OWNERSHIP: A DETAILED EXAMINATION OF SIGNIFICANT BENEFICIAL OWNERSHIP AND CONTEMPORARY TRENDS

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Introduction

In the landscape of corporate governance and regulatory compliance in India, the concept of significant beneficial ownership ("**SBO**") has lately emerged as a critical focal point. This heightened attention is primarily due to a series of rigorous actions taken by the various Registrar of Companies ("**RoCs**") against notable entities, including multinational giants such as LinkedIn and Samsung. These developments underscore the increasing importance for businesses to thoroughly understand and adhere to SBO regulations not only to maintain transparency but also to avoid punitive measures.

The overarching objective of identifying an SBO is to determine the ultimate beneficial owners behind a company's shares, particularly in complex and layered corporate structures. By mandating comprehensive disclosures, the Indian regulators aim to foster a more transparent corporate environment, thereby mitigating the risks associated with hidden ownership and enhancing corporate governance standards. Also, the requirement for the companies to ascertain SBOs originates from the recommendations in the Financial Action Task Force ("**FATF**") 'Guidance on Beneficial Ownership for Legal Persons'.[3] The objective of the FATF standards on transparency and beneficial ownership is to prevent the misuse of corporate entities for money laundering or terrorist financing. Comparable regulations exist in FATF-aligned nations.

This article aims to offer readers a comprehensive overview of the current Indian regulations regarding SBO and the latest developments in enforcement by regulatory authorities.

SBO under the Companies Act, 2013

The Ministry of Corporate Affairs ("**MCA**") in India has been diligently working to enhance transparency in corporate ownership structures. In this context, the MCA amended the provisions

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[3] Financial Action Task Force (FATF), 'Guidance on Beneficial Ownership for Legal Persons', 2023, available at https://www.fatf-gafi.org (last visited June 24, 2024).

of Section 90 of the Companies Act, 2013 ("**Companies Act**") and notified the Companies (Significant Beneficial Owners) Rules, 2018[4] ("**Principal Rules**"), effective from June 13, 2018. To strengthen the framework, the MCA further amended the provisions under the Principal Rules by enacting the Companies (Significant Beneficial Owners) Amendment Rules, 2019[5] ("**Amendment Rules**"), effective from February 8, 2019. For the purpose of this article, the Principal Rules and the Amendment Rules are hereinafter collectively referred to as "**SBO Rules**".

Understanding the 'Reporting Company'

The term 'reporting company' is the foundation of the SBO Rules. As per Rule 2(f)[6] of the Principal Rules, a reporting company is any company (*as defined under Section 2(20) of the Companies Act*) that is mandated to comply with the provisions of Section 90 of the Companies Act. This compliance is critical for ensuring that companies disclose their ultimate beneficial owners, thereby fostering transparency and accountability.

Key provisions of Section 90 and SBO Rules

The provisions of Section 90 of the Companies Act and the SBO Rules represent a comprehensive framework aimed at identifying and regulating SBO in Indian companies. These provisions can be bifurcated into four primary aspects:

1. Identification of an SBO: This involves identifying individuals who, directly or indirectly, hold a substantial interest in the company's shares or exercise significant control over the company. The precise thresholds and criteria for identification are meticulously analysed hereinafter to ensure clarity and uniform application.

2. Declaration by SBO: Once identified, the SBO is required to make a formal declaration to the reporting company. This declaration must disclose the nature and extent of their beneficial interest. The timely and accurate submission of this declaration is crucial for maintaining transparency in the company's ownership structure.

[4] Companies (Significant Beneficial Owners) Rules, 2018
[5] Companies (Significant Beneficial Owners) Amendment Rules, 2019
[6] Companies (Significant Beneficial Owners) Rules, 2018, Rule 2(f)

3. Registers and returns by the reporting company: The reporting company has an obligation to maintain registers and file returns that reflect the information provided by the SBO. These registers must be kept up-to-date and made accessible to regulatory authorities. Additionally, the company must comply with various procedural requirements, including the filing of periodic returns that encapsulate the beneficial ownership details.

4. Penalties for non-compliance and investigative powers: To ensure stringent adherence to these provisions, Section 90 of the Companies Act and the SBO Rules impose significant penalties for non-compliance. These penalties can be levied on both the reporting company and the SBO for failing to comply with the declaration and reporting requirements. Moreover, the Companies Act empowers authorities to investigate any discrepancies or violations, thereby reinforcing the regulatory framework.

Identification of an SBO

The key objective of the SBO Rules is the identification of an SBO. It is important to note that Section 90(1) of the Companies Act specifies a 25% threshold, or **such other percentage as may be prescribed**, for SBO disclosure. Consequently, the SBO Rules have established a lower threshold of 10%, as discussed further below. An SBO in relation to a reporting company means **an individual** who, acting alone or with others, or through one or more entities or trusts, possesses **one or more of the following rights or entitlements in the reporting company**:

1. holds indirectly, or together with any direct holdings, **not less than 10%** of the shares;

2. holds indirectly, or together with any direct holdings, **not less than 10%** of the voting rights in the shares;

3. has 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, or together with any direct holdings;

4. has right to exercise, or actually exercises, **significant influence or control**, in any manner other than through direct holdings alone.

The first three criteria are objective whereas the **fourth criterion necessitates a subjective and qualitative assessment** which has been the fountainhead of controversy in the latest orders passed by the RoCs.

If any individual, or individuals acting through any person or trust, share a **common intent or purpose** to exercise any rights or entitlements, or to exert control or significant influence over a reporting company, whether through a formal or informal agreement or understanding, such individual or individuals shall be deemed to be 'acting together'.

If an individual does not meet the criteria mentioned in (1) to (3) above through indirect holdings, they are not considered an SBO.

Direct and Indirect Holdings

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:

1. The shares representing such rights or entitlements are held in the individual's name.

2. The individual holds or acquires a beneficial interest in the shares under Section 89(2) (*Declaration in respect of beneficial interest in any share*) of the Companies Act and has made a declaration to this effect to the reporting company.

'Control' and 'Significant Influence'

The terms '**control**' and '**significant influence**' are crucial for determining beneficial ownership. '*Control*' under the Companies Act 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.[7] '*Significant influence*' refers to the power to participate, directly or indirectly, in the financial

[7] Companies Act, 2013, § 2(27), No. 18, Acts of Parliament, 2013 (India).

and operating policy decisions of the reporting company but is not control or joint control of those policies.[8]

On careful reading, the test of '**control**' and '**significant influence**' involve a subjective assessment on the basis of the facts of each case. In light of recent orders passed by the RoCs, wherein the RoCs have applied an expansive interpretation to these terms, we have attempted to examine this aspect below in greater detail.

Determining SBO in case of persons other than individuals

The SBO Rules provide specific criteria for identifying an SBO in non-individual entities. Also, for determining SBO, instruments in the form of global depository receipts, compulsorily convertible preference shares or compulsorily convertible debentures have to be treated as 'shares'.

1. Body Corporate (excluding LLPs):

    - The individual holding a majority stake in the member body corporate or its ultimate holding company is the SBO.
    - A majority stake is defined as holding more than half of the equity share capital, voting rights, or the right to receive more than half of the distributable dividend.

2. Hindu Undivided Family (HUF):

    - The Karta of the HUF is considered the SBO.

3. Partnership Entity (*a partnership firm registered under the Indian Partnership Act, 1932 or a limited liability partnership registered under the Limited Liability Partnership Act, 2008*): The SBO will be an individual who is:

    - A partner,
    - holding a majority stake in the body corporate which is a partner of the partnership entity, or

[8] Companies (Significant Beneficial Owners) Rules, 2018, Rule 2(1)(i).

- holding a majority stake in the ultimate holding company of the body corporate which is a partner of the partnership entity.

4. Trust (*through a trustee*): The SBO will be an individual who is:

   - a trustee in case of a discretionary trust or a charitable trust,
   - a beneficiary in case of a specific trust, or
   - the author or settlor in case of a revocable trust.

5. Pooled Investment Vehicle (*or an* ***entity controlled by the pooled investment vehicle*** *based in a member state of the FATF on Money Laundering, and the regulator of the securities market in such member State is a member of the International Organization of Securities Commissions (****IOSCO****)*): The SBO will be **an individual in relation to the pooled investment vehicle ("PIV")** who is:

   - a general partner ("**GP**"); or
   - an investment manager; or
   - a chief executive officer ("**CEO**") where the investment manager of such pooled vehicle is a body corporate or a partnership entity.

   Following the recent adjudication orders by RoCs related to SBOs, a view may be formed that in the event, the GP of the fund in question is another body corporate or partnership then:

   - assuming the investment manager(s) of the fund are individuals, then they will be considered as the SBO, or
   - assuming the investment manager(s) is a body corporate or partnership, then CEO(s) of the investment manager(s) will be considered as the SBO.

   In our view, while identifying a person, **one should not strictly go by the designation titled as 'CEO' but by the intent i.e., who is the person in charge of an investment manager which is a body corporate or a partnership entity**.

   For entities in jurisdictions not meeting the aforesaid criteria of pooled investment vehicle or an entity controlled by the pooled investment vehicle, the rules applicable to body corporates, HUFs, partnership entities, and trusts will apply.

Obligations of SBOs

The SBO has the below listed obligations under the SBO Rules:

1. Every SBO must file a declaration using Form BEN-1 with the reporting company.

2. This declaration: (a) was required to be filed within 90 days of the commencement of the Amendment Rules (by May 8, 2019), and (b) is now required to be filed within 30 days of acquiring or change of SBO, where the individual subsequently becomes an SBO or where his SBO status undergoes any change.

Responsibilities of Reporting Companies

The reporting companies are tasked with several responsibilities to ensure compliance with the SBO Rules:

1. Filing with RoCs: The declaration of beneficial interest received must be filed with the RoCs in Form BEN-2 within 30 days of receipt.

2. Maintaining a Register: A register of SBOs must be maintained in Form BEN-3.

3. Identifying an SBO: The reporting companies must identify individuals who are SBOs and ensure their compliance. This involves compulsorily sending notices in Form BEN-4 to non-individual members holding not less than 10% shares, voting rights, or dividend rights. Recent legal adjudication orders relating to SBO have sparked a debate on whether the reporting company should proactively identify an individual SBO who may be exercising significant influence or control at ultimate holding company level, and subsequently issue a notice in Form BEN-4. It is advisable the reporting company should exercise diligence in identifying an individual SBO by proactively approaching its relevant members for necessary information. The information requested in Form BEN-4 must be provided by the concerned member within a period not exceeding 30 days from the date of the notice.

4. Application to the National Company Law Tribunal ("**NCLT**"): When a person fails to furnish the information required by the notice in Form BEN-4 within 30 days, or the information provided is inadequate, the reporting company is mandated to apply to the NCLT. This application must be made within 15 days following the expiration of the period specified in the notice. The reporting company may seek an order from the NCLT to impose certain restrictions on the shares in question. The potential restrictions include:

   - **Restrictions on Transfer**: The NCLT can order restrictions on the transfer of interest attached to the shares in question. This measure ensures that the shares cannot be transferred without appropriate disclosures and compliance with the SBO Rules.
   - **Suspension of Dividend Rights**: The NCLT can suspend the right to receive dividends or any other distribution related to the shares. This suspension serves as a significant deterrent for non-compliance, as it directly impacts the financial benefits derived from the shares.
   - **Suspension of Voting Rights**: The NCLT can suspend the voting rights associated with the shares. This measure prevents the non-compliant person from influencing corporate decisions through their shareholding.
   - **Other Restrictions**: The NCLT may impose any other restriction on the rights attached to the shares to ensure compliance with the SBO Rules.

   The company or any person aggrieved by the order of the NCLT has the right to apply for relaxation or lifting of the restrictions imposed. This application must be made within 1 year from the date of the NCLT order. If no such application is filed within the said period, the shares in question will be transferred without any restrictions to Investor Education and Protection Fund constituted under Section 125(5) of the Companies Act.

Penalties for Non-Compliance and Investigative Powers

The SBO Rules impose stringent penalties for non-compliance:

1. For SBO: Failure to make a declaration results in a penalty of INR 50,000 and an additional INR 1,000 per day for continuing failures, subject to a maximum limit of INR 200,000.

2. For Reporting Companies: Failure to issue Form BEN-4 for identifying an SBO, maintain the register, or file necessary information, or denial to inspection of the register to any member of the reporting company, results in a penalty of INR 100,000, with additional penalties for continued failures, subject to a maximum limit of INR 500,000. Officers in default are also penalized subject to a maximum limit of INR 100,000.

3. False Information: Wilful furnishing of false information or suppression of material information can lead to imprisonment and fines under Section 447 (*Punishment for fraud*) of the Companies Act.

Exemptions

Certain entities are exempt from the SBO Rules to the extent of their shareholding in the reporting company. These include:

1. Authorities constituted under Section 125(5) of the Companies Act (*i.e., authority for administration of Investor Education and Protection Fund*).

2. The holding reporting company, provided that the details of such holding reporting company shall be reported in Form BEN-2.

3. The Central Government, State Government, or local authorities.

4. Government-controlled entities.

5. Securities and Exchange Board of India ("**SEBI**") registered investment vehicles such as mutual funds, alternative investment funds (AIFs), Real Estate Investment Trusts (REITs), Infrastructure Investment Trust (InVITs).

6. Investment vehicles regulated by Reserve Bank of India ("**RBI**"), Insurance Regulatory and Development Authority of India (IRDAI), or Pension Fund Regulatory and Development Authority (PFRDA).

SBO under the Limited Liability Partnership Act, 2008

The MCA, pursuant to a notification dated February 11, 2022, had extended the applicability of the provisions of Section 90 relating to SBOs to limited liability partnerships ("**LLPs**"). This change ensures uniform regulatory standards across different business entities, thereby promoting greater transparency and accountability within the corporate sector.

Despite the aforesaid notification, there remained ambiguity regarding the applicability of the SBO Rules to the LLPs. This lack of clarity created uncertainty for the LLPs concerning their compliance obligations under the SBO framework.

To ensure greater clarity, the MCA notified the Limited Liability Partnership (Significant Beneficial Owners) Rules, 2023 ("**LLP SBO Rules**") on November 9, 2023.

The LLP SBO Rules closely mirror the SBO Rules, with a few necessary modifications tailored to LLPs compliance requirements. Therefore, this article does not delve into the specific provisions of the LLP SBO Rules.

Beneficial Ownership under the Foreign Exchange Laws

The Government of India, through Press Note (03 of 2020) dated April 17, 2020 ("**Press Note 3**"), amended India's foreign direct investment policy. Pursuant to the Press Note 3, Paragraph 3.1.1. (a) of the Consolidated Foreign Direct Investment Policy now mandates that an entity of a country that shares their land borders with India *(i.e., Afghanistan, Bangladesh, Bhutan, China (including Hong Kong and Macau), Myanmar, Nepal and Pakistan*) ("**Land Border Countries**") shall invest in India, only with the prior approval of the Government. This measure aims to safeguard local entities from potential acquisitions at distressed valuations. Investment into India would require Government approval in cases where the beneficial owner of an investment in India is situated in Land Border Countries or is a citizen of the Land Border Countries. Further, any change in the ownership (by way of transfer or otherwise) of any existing or future Foreign Direct Investment ("**FDI**") in an entity in India (directly or indirectly) that results in beneficial ownership being held by a person situated in Land Border Countries or a citizen of Land Border Countries, will require the prior approval of the Government of India.

In our view, the Press Note 3 has two limbs:

1. **direct ownership** – in this scenario, even the transfer of a single share of a company to an investor from any of the Land Border Countries necessitates prior approval from the Government of India; and

2. **beneficial ownership** – currently the term '**beneficial owner**' is neither defined nor is the method of its computation mentioned under the Press Note 3, Foreign Exchange Management Act, 1999, or Foreign Exchange Management (Non-debt Instruments) Rules, 2019. However, the Department for Promotion of Industry and Internal Trade (DPIIT) has issued the Standard Operating Procedures dated November 9, 2020 ("**SOP**") for processing the FDI proposals. **Annexure 1 to the SOP** provides the list of documents required with the application, including the **details of the SBO** of both the investor company and the investee company, as **prescribed under the Companies Act and its rules**. The Companies Act, read with the SBO Rules, sets a threshold for determining an SBO, which includes holding of not less than 10% of shares, holding of not less than 10% of voting rights, or having the right to receive or participate in not less than 10% of the total distributable dividend. Further, the proforma for application for security clearance for FDI proposals (*applicable under Press Note 3*) requires disclosure of "ultimate beneficial ownership" (*without defining the said term*) along with **details of shareholders holding more than 10% of shares in the investor company**. This suggests that the **threshold of 10% or more** is crucial in determining beneficial ownership for these purposes.

Beneficial Ownership under SEBI regulations

SEBI issued a master circular dated December, 31, 2010, on Anti-Money Laundering (AML) Standards and Combating the Financing of Terrorism (CFT) /Obligations of Securities Market Intermediaries under the Prevention of Money-laundering Act, 2002 ("**PMLA**") and rules framed thereunder, which defines a beneficial owner as:

> "*a natural person or persons who ultimately own, control or influence a client and/or persons on whose behalf a transaction is being conducted. It also incorporates those persons who exercise ultimate effective control over a legal person or arrangement.*"[9]

As per the circular, all intermediaries registered with SEBI are required to obtain, as part of their client due diligence policy, client details and accordingly identify persons holding beneficial ownership or control in the securities account.

SEBI thereafter released Guidelines on Identification of Beneficial Ownership dated January, 24, 2013, to be followed by all intermediaries registered with SEBI to identify clients with beneficial owner.[10]

As per the aforesaid guidelines:

1. **Where the client is a person (other than an individual or trust), viz., company, partnership or unincorporated association/body of individuals**: the intermediary shall identify the beneficial owners of the client and take reasonable measures to verify the identity of such persons, through the following information:

    a. The identity of the natural person, who, whether acting alone or together, or through one or more juridical person, exercises control through ownership or who ultimately has a controlling ownership interest.

    Explanation: Controlling ownership interest means ownership of/entitlement to: (i) more than **25%** of shares or capital or profits of the juridical person, where the juridical person is a company; (ii) more than **15%** of the capital or profits of the juridical person, where the juridical person is a partnership; or (iii) more than **15%** of the property or capital or profits of the juridical person, where the juridical person is an unincorporated association or body of individuals.

[9] SEBI Master Circular No. CIR/ISD/AML/3/2010 dated December 31, 2010, https://www.sebi.gov.in/legal/master-circulars/dec-2010/aml-cft-master-circular_14421.html (last visited June 24, 2024).

[10] SEBI Circular No. CIR/MIRSD/2/2013 dated January 24, 2013, https://www.sebi.gov.in/legal/circulars/jan-2013/guidelines-on-identification-of-beneficial-ownership_24206.html (last visited June 24, 2024).

b. In cases where there exists doubt under para 1 (a) above as to whether the person with the controlling ownership interest is the beneficial owner or where no natural person exerts control through ownership interests, the identity of the natural person exercising control over the juridical person through other means.

Explanation: Control through other means can be exercised through voting rights, agreement, arrangements or in any other manner.

c. Where no natural person is identified under paras 1 (a) or 1 (b) above, the identity of the relevant natural person who holds the position of senior managing official.

2. **Where the client is a trust**: the intermediary shall identify the beneficial owners of the client and take reasonable measures to verify the identity of such persons, through the identity of the settler of the trust, the trustee, the protector, the 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.

The said guidelines mentioned that intermediaries who were dealing with foreign investors' viz., Foreign Institutional Investors, Sub Accounts and Qualified Foreign Investors, may be guided by the clarifications issued in another SEBI circular dated September 5, 2012, for the purpose of identification of beneficial ownership of the client.[11]

The aforesaid guidelines contemplate that in case where the client is a company listed on stock exchange, the intermediary is exempted from identification/verification of beneficial owner of such companies. However, SEBI changed the above stance and introduced the disclosure requirements for listed entities (who are reporting companies under the SBO Rules) to disclose details pertaining to SBOs along with shareholding pattern by issuing a circular dated December 7, 2018[12] (which was further modified on March 12, 2019)[13] modifying the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

[11] SEBI Circular No. CIR/MIRSD/11/2012 dated September 05, 2012, https://www.sebi.gov.in/legal/circulars/sep-2012/know-your-client-requirements_23379.html (last visited June 24, 2024).
[12] SEBI Circular No. SEBI/HO/CFD/CMD1/CIR/P/2018/0000000149 dated December 07, 2018, https://www.sebi.gov.in/legal/circulars/dec-2018/disclosure-of-significant-beneficial-ownership-in-the-shareholding-pattern_41245.html (last visited June 24, 2024).
[13] SEBI Circular No. SEBI/HO/CFD/CMD1/CIR/P/2019/36 dated March 12, 2019, https://www.sebi.gov.in/legal/circulars/mar-2019/modification-of-circular-dated-december-7-2018-on-disclosure-of-significant-beneficial-ownership-in-the-shareholding-pattern_42324.html (last visited June 24, 2024).

The below details are required to be disclosed by the listed entities (reporting companies under the SBO Rules):

- Details of SBO;
- Details of the registered owner;
- Details of shareholding/exercise of right by the SBO (whether direct or indirect) in the reporting company; and
- Date of creation/acquisition of significant beneficial interest.

Beneficial Ownership under PMLA

To implement the recommendations of the FATF to combat money laundering and terrorist financing, the Prevention of Money-laundering (Maintenance of Records) Rules, 2005 ("**PML Rules**") framed under PMLA provide for identification of beneficial owner as part of client due diligence by the reporting entity including a banking company, financial institution, intermediary, etc.

Rule 9 of the PML Rules requires the reporting entity while carrying out specific transactions to determine whether the client is acting on behalf of a beneficial owner and identify and verify the identity of the beneficial owner, using independent verification sources.

Below are the various thresholds to determine the beneficial owner:

Serial No.	**Nature of client**	**Ownership threshold to determine beneficial owner** (*the natural person, who, whether acting alone or together, or through one or more juridical person*)
1.	Company	Owns **more than 10%** shares or capital or profits of the company Or who exercises "Control" meaning right to appoint majority of the directors or to control the management or policy decisions including by virtue of their shareholding or

Serial No.	**Nature of client**	**Ownership threshold to determine beneficial owner** (*the natural person, who, whether acting alone or together, or through one or more juridical person*)
		management rights or shareholders agreements or voting agreements
2.	Partnership firm	Owns **more than 10%** of capital or profits of the partnership Or Who exercises "Control" meaning right to control the management or policy decision
3.	Unincorporated association or body of individuals	Owns **more than 15%** of the property or capital or profits of such association or body of individuals
4.	Trust	Include identification of the author of the trust, the trustee, the beneficiaries with 10% percent 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

Furthermore, where no natural person is identified under (1) or (2) or (3) in the table above, the **beneficial owner is the relevant natural person who holds the position of senior managing official**.

Now let's examine various orders of RoC in order to understand how the regulator is interpreting the SBO Rules.

Order by RoC Delhi in the matter of LinkedIn India

Recently, in the matter of LinkedIn Technology Information Private Limited ("**LinkedIn India**"), the theory of SBO was tested and interpreted expansively by RoC Delhi sending ripples through MNC's on account of the potential implications of such interpretation over the understanding and practices prevalent.

A routine filing by LinkedIn India for declaring a nominee and beneficial ownership arrangement over a single share of LinkedIn India held by group entities of LinkedIn India piqued the attention of RoC Delhi. This resulted in a show cause notice and several exchanges of correspondence between RoC Delhi and LinkedIn India, ultimately culminating in adjudication proceedings in which penalties were levied on LinkedIn India, its directors and most importantly, RoC Delhi held that Mr. Satya Nadella (of Microsoft Corporation) and Mr. Ryan Roslansky (Global CEO of LinkedIn Group) were SBOs of LinkedIn India.

Through the several queries posted by RoC Delhi from time to time, it was revealed that LinkedIn India did not consider there to be an SBO as it was ultimately held by Microsoft Corporation, a listed company in which there were no single individual or entity that controlled 10% or more of its shareholding. LinkedIn India maintained that Microsoft Corporation (ultimate holding company) and its subsidiary, i.e., LinkedIn Corporation, were professionally run companies (as opposed to promoter led companies) without any SBO.

However, RoC Delhi delved deep and assessed the issue of beneficial ownership not just from a shareholding point of view but also from a chain of reporting and financial control standpoint.

1. Shareholding (holding-subsidiary relationship)

LinkedIn Corporation and LinkedIn India are both subsidiaries of Microsoft Corporation. While LinkedIn India had disclosed LinkedIn Corporation as its holding company in its financial statements; it was however noted that LinkedIn Corporation did not have any shareholding in LinkedIn India. This led RoC Delhi to observe that LinkedIn Corporation could be regarded as a "Holding Company" (despite lack of any shareholding in LinkedIn India) only if it satisfied the other limbs of Section 2(87) of the Companies Act, i.e., on account of its ability to control the board of LinkedIn India. RoC Delhi held that if LinkedIn Corporation did not have the ability to control the board of LinkedIn India, it ought to have been designated as a sister concern or a fellow subsidiary and not as a holding company in LinkedIn India's financial statements.

Delving deeper, RoC Delhi analysed the composition of the board of LinkedIn India and LinkedIn Corporation and found that two of the directors of LinkedIn India were also directors in LinkedIn Corporation. RoC Delhi argued that a group of persons cannot control

themselves (as same persons are on the board of both LinkedIn Corporation and LinkedIn India) and deduced that the actual 'control' lay elsewhere. It reached a conclusion that Mr. Ryan Roslansky, the CEO as well as the President of LinkedIn Corporation was the medium through which such 'control' was exercised by LinkedIn Corporation over the board of LinkedIn India. Further, as Mr. Ryan Roslansky was found to report to Mr. Satya Nadella (CEO and Chairman of Microsoft Corporation), RoC Delhi determined that it was Mr. Ryan Roslansky and Mr. Satya Nadella who were the SBOs of LinkedIn India.

2. Reporting Channels

RoC Delhi rejected the contention of LinkedIn India that its employees were invited to be on its board and were not nominees of Microsoft Corporation. RoC Delhi noted that the directors of LinkedIn India were directors of several other LinkedIn and Microsoft group entities across the globe and their tenures were co-terminus with their exit from the parent entities. This led RoC Delhi to conclude that the directors were appointed to protect Microsoft Corporation's interests and as such they were liable to be classified as nominees of Microsoft Corporation under Section 161(3) of the Companies Act. Mr. Satya Nadella is the CEO and Chairman of Microsoft Corporation with general charge and supervision of business and Mr. Ryan Roslansky reports to Mr. Nadella. Further, most directors of LinkedIn India report to Mr. Roslansky or ultimately, to Mr. Nadella. The composition of the board of LinkedIn India which were taken from a pool of employees around the world and their common directorships in multiple LinkedIn entities and their reporting channels led to establishing a line of control between Mr. Satya Nadella and Mr. Ryan Roslansky with the board of LinkedIn India. RoC Delhi held that the right to exercise significant control does not require there to be proof of existence of actual exercise of such control.

3. Financial Control

RoC Delhi also examined the financial controls in place in LinkedIn India and assessed that irrespective of the powers of board of LinkedIn India, the ultimate financial control of transactions of LinkedIn India were with identified employees of Microsoft Corporation, under the overall supervision of its CEO/Chairman – Mr. Satya Nadella. RoC Delhi also observed that such financial controls were independent of the controls the board of LinkedIn

India. This negated the contention of LinkedIn India that it is run by the board with external financial controls necessitated only for prevention of fraud.

Thus, RoC Delhi concluded that it is not just shareholding that is relevant in determination of an SBO but also the right to exercise control in respect of the entity in question. The aforesaid tests were justified from RoC Delhi's point of view to hold Mr Satya Nadella and Mr. Ryan Roslansky as the SBO's of LinkedIn India – irrespective of their lack of shareholding in LinkedIn India – and to impose a cumulative penalty of INR 2,700,000 on LinkedIn India, its directors and Mr. Ryan Roslansky and Mr. Satya Nadella.

The expansive interpretation by RoC Delhi appears to pierce the corporate veil for determining an SBO. The RoC's action demonstrates that SBO reporting cannot be treated as a routine or casual matter and will have to be looked into greater detail by the reporting entity and its members. Also, the ROC's order demonstrates the complications which arise if the parent group participates in the affairs of the reporting entity.

It is interesting to note that RoC Delhi also countered LinkedIn India with proof of Microsoft Corporation regularly filing statement of changes in beneficial ownership of securities with the Securities and Exchange Commission (SEC) and asked LinkedIn India to show cause as to why it has not made any analogous filings required under the SBO Rules.

Order by RoC Kanpur in the matter of Samsung SDI India Private Limited and Samsung Display Noida Private Limited

RoC Kanpur passed two separate orders against Indian companies of Samsung Group and broadly analysed the principles concerning SBOs. Samsung SDI India Private Limited ("**Samsung SDI India**") and Samsung Display Noida Private Limited ("**Samsung Display India**"), along with their directors and key managerial personnels, were penalised for non-compliance of identification and reporting of SBOs as required by the SBO Rules.

As mentioned in the SBO Rules, it is the duty of the reporting company to identify SBOs and ensure compliance with them.

Upon examination of the filings made by Samsung SDI India, RoC Kanpur noticed that Samsung SDI India did not comply with the requirement of declaration of an SBO under the SBO Rules; hence, a notice dated February 13, 2024, was issued to Samsung SDI India. In its reply, Samsung SDI India disclosed its shareholding details indicating it is a subsidiary of Samsung SDI Co. Ltd., Korea ("**SDI Korea**") and asserted it was not required to file a return of the declaration under Form BEN-2 as no individual, either acting alone or together, possesses the rights beyond the thresholds, voting rights, distributable dividend or the right to exercise or actually exercises control or significant interest in Samsung SDI India.

Being dissatisfied with this explanation, a show cause notice dated April 15, 2024 ("**Samsung SCN**") was issued by RoC Kanpur to Samsung SDI India for non-compliance with the SBO Rules.

Contentions of Samsung SDI India in response to the Samsung SCN

Samsung SDI India reiterated its stance that Section 90 of the Companies Act read with the SBO Rules are not applicable to them, as Samsung SDI India is a separate legal entity being run by an independent board of directors and professional management. They further argued that no individual holds a majority stake in the holding or ultimate holding company of Samsung SDI India thereby asserting that it is not subject to significant influence or control by any individual.

RoC Kanpur's observations

RoC Kanpur conducted a thorough examination and requested additional clarifications and information including details of shareholders, promoters, directors, etc., of major group companies of Samsung where the promoters had cross holdings, details of ultimate beneficial owner ("**UBO**") of Samsung SDI India disclosed to the banks, etc. In response to these queries, Samsung SDI India submitted an incomplete reply and reiterated its earlier stance. An extensive analysis of the details submitted by Samsung SDI India and publicly available information, led to the following findings:

1. **UBO of the reporting company disclosed to Citi Bank**

   Samsung SDI India had declared Mr. Myeong Gyu Choi (director of Samsung SDI India) as the UBO at the time of opening of current account in India. As per the declaration submitted

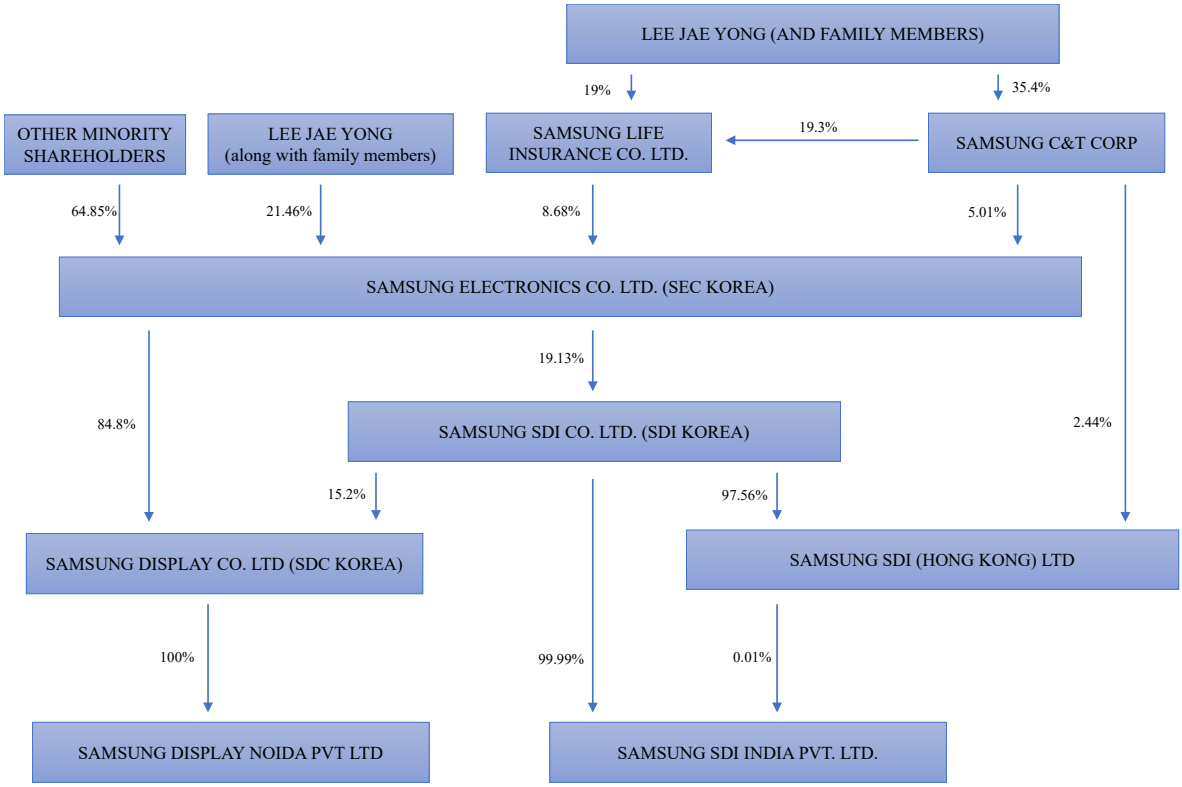
to Citi Bank, Mr. Myeong Gyu Choi has been serving as the Chairman and CEO of Samsung SDI India since 2019. It was also mentioned in the declaration that Samsung SDI India is a 'Closely Held Company' (wherein a single natural person/beneficial owner along with the relatives holds more than 76% shares in the company). **RoC Kanpur held that Samsung SDI India should have declared the name of the SBO under the SBO Rules as well**.

2. Disregard of 'control' and 'significant influence' principles

The argument that no individual possesses more than 10% shareholding in the holding and ultimate holding company of Samsung SDI India was based on self-evaluation of the ownership of shares held by the individual, of the holding company. However, the other parameters for identification of SBOs namely, nature of indirect holding(s), voting rights in shares, exercise of control and significant influence were completely overlooked.

Relying on information available in the public domain and the consolidated financial statements of Samsung Electroincs Company Limited, Korea ("**SEC Korea**") submitted by Samsung Display India, RoC Kanpur observed that SEC Korea has 100% ownership (voting rights in each entity including subsidiaries) in SDI Korea and thus in Samsung SDI India.

Mr. Lee Jae-Yong and his family members have more than 25% stake in the shareholding and voting rights in SEC Korea. Being a public listed company, any person having more than 25% can be said to have significant influence and control in the company. RoC Kanpur held that Mr. Lee Jae-Yong exercises control over SEC Korea as it has a large stake in the said company indirectly through cross-ownership in subsidiaries.



Further, Mr. Lee Jae-Yong was appointed as the executive chairman of SEC Korea in 2022. However, Samsung SDI India stated that no individual has control or significant influence on SEC Korea (ultimate holding company). RoC Kanpur held that Samsung SDI India should have declared SBO under the SBO Rules post appointment of Mr. Lee Jae-Yong as the executive chairman and should have sought compliance from him by issuing a notice seeking information.

Moreover, Samsung SDI India was required to seek information regarding SBO from the immediate holding company through notice under Form BEN-4, as Samsung SDI India is a wholly owned subsidiary, regardless of whether there is an SBO. Due to this, Samsung SDI India failed in its duty to identify and ascertain SBO under the SBO Rules.

A similar investigation was concurrently conducted by RoC Kanpur on another group entity Samsung Display, resulting in similar conclusions.

It is noteworthy that unlike LinkedIn India order, RoC Kanpur penalised only the Indian reporting company and its officers, without extending the penalties to the identified SBOs in these matters.

Order by RoC Delhi in the matter of Leixir Resources Private Limited

On May 6, 2024, RoC Delhi passed an order concerning Leixir Resources Private Limited ("**Leixir India**") imposing penalty on Leixir India, its officers, Mr. William Marshall Griffin (director of the Comvest Group, i.e., the parent group) and Mr. Michael Falk (CEO of the investment manager entity of the ultimate holding company) for their failure to identify and report SBO as required by the SBO Rules.

Chain of correspondences between RoC Delhi and Leixir India

1. **RoC Delhi issued notice, dated February 7, 2024, to Leixir India to ascertain compliance of the SBO Rules.**

   Reply: Leixir India in its reply dated February 20, 2024, contested the application of the SBO Rules, asserting that no individual holds any indirect right or entitlement to be considered as the SBO. It argued that Comvest Leixir Holdings LLC is the ultimate holding company and Comvest Investments Partners V LP (PIV) ("**LP 1**") holds 54.32% shareholding in the ultimate holding company. Further, there is no individual who is general partner, investment manager or CEO in relation to LP 1, as the investment manager is a body corporate.

2. **Clarifications sought, *vide* e-mail dated March 12, 2024, from Leixir India**.

   Details regarding name and holding of limited and general partners of LP 1 and Comvest Investment Partners V-A LP ("**LP 2**"), proper disclosure in Form DIR-12 about partners, professionals, etc., of the Comvest Group who are actually nominee directors of the said company and why they haven't been declared as SBO of Leixir India, etc., was requested by RoC Delhi.

   Reply: Leixir India submitted its reply on March 19, 2024. It did not submit the details of limited and general partners of LP 1 and LP 2. It stated that the partners and professionals were appointed as non-executive directors as they were not drawing any renumeration or benefit from the subject company and were not involved in daily operations. Therefore, the said appointed directors had no significant influence or control on Leixir India.

3. **RoC Delhi issued a show cause notice on March 22, 2024 to Leixir India**.

Certain issues regarding non-disclosure of LP 1 as the ultimate holding company (being a body corporate) if it holds a majority stake in Comvest Leixir Holdings LLC and non-declaration of CEO of the investment manager entity of LP 1 as the SBO were brought to the notice of RoC Delhi.

Reply: Leixir India in its reply, *vide* e-mail dated April 8, 2024, contended that the provisions under the SBO Rules pertains to the CEO of the PIV and not to the CEO of the investment manager. It reiterated that there is no individual in LP 1 who serves as general partner, investment manager or CEO.

4. **RoC Delhi raised queries and scheduled a hearing on April 29, 2024**.

Dissatisfied with the reply to the show cause notice, further queries were raised regarding additional information of LP 1, proof of shareholding of all layers, role of Mr. Adam Kollender as investment manager or general partner of LP 1, etc.

Reply: Leixir India submitted its reply, *vide* e-mail dated April 22, 2024, before the hearing. It stated that the general partner for LP 1 and LP 2 is an entity – Comvest V Partners LP. This entity further delegates management of LP 1 and LP 2 to Comvest Advisors LLC ("**investment manager entity**") and the CEO of the investment manager entity is Mr. Michael Falk. Investment decisions are taken by committees and not on individual basis. Mr. Adam Kollender is an employee of the investment manager entity but does not hold any management position. Therefore, they do not exercise any rights or entitlements or control or significant control over Leixir India.

5. **RoC Delhi raised queries based on submissions of Leixir India during the hearing**.

Queries pertained to reporting channel of directors of Leixir India, details of directors of the subject company who are nominees of Comvest Group, why Mr. Michael Falk should not be considered as an SBO, etc.

Reply: *Vide* e-mail dated May 3, 2024, Leixir India replied that the directors of Leixir India act independently. They report Leixir India's performance to the shareholders including the immediate holding company (ultimately controlled by LP 1 and LP 2). It was submitted that Mr. William Marshall Griffin and Mr. Krishna Srirama Bhadriraju (employees of Comvest Group) were appointed as non-executive additional directors of Leixir India. Despite of Mr. Michael Falk being the CEO of the investment manager entity, the decisions concerning investment funds are made by various committees.

RoC Delhi's observations

1. **Identification of ultimate holding company**

RoC Delhi held that as per the information provided by Leixir India, LP 1 holds 54.32% shareholding in Comvest Leixir Holdings LLC. By virtue of this fact, LP 1 is the ultimate holding company of Leixir India. The member of Leixir India (Leixir Intermediate Corp.) is controlled by LP 1 and therefore, the SBO Rules will apply in this case.

2. **Determination of SBO**

Both LP 1 and LP 2 do not have CEOs and are managed by the investment management entity. It is clearly mentioned in the provision under the SBO Rules that an individual in relation to the PIV, is a CEO where the investment manager of such pooled vehicle is body corporate or partnership entity. The CEO is to be identified only when the investment manager is a corporate body. The very purpose of this Rule 2(1)(h) Explanation III(v) is to identify an individual in relation to the PIV which indirectly controls the member of Leixir India. For this purpose, RoC Delhi referred to the Supreme Court ruling in the case of ***Indian Social Action Forum (INSAF) v. Union of India***[14] wherein the principle of purposive construction was explained as –

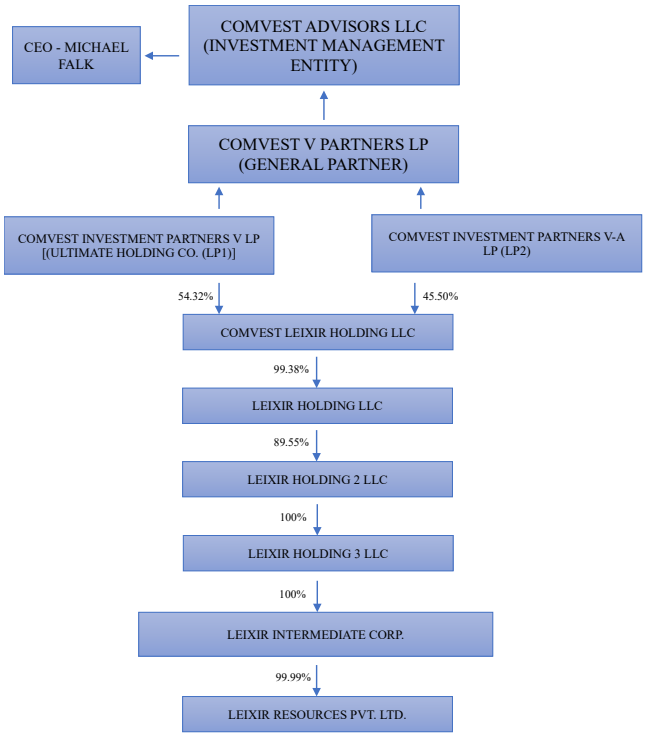
"*It is settled principle of interpretation that the provisions of the statute have to be interpreted to give the words a plain and natural meaning. But, if there is scope for two interpretations, the Courts have preferred purposive construction, which is now the predominant doctrine of*

[14] Indian Social Action Forum (INSAF) v. Union of India, AIR 2020 SC 1363.

interpretation. In case of ambiguity in the language used in the provision of a statute, the Courts can take aid from the historical background, the Parliamentary debates, the aims and objects of the Act including the long title, and the endeavour of the Court should be to interpret the provisions of a statute to promote the purpose of the Act."

The investment management entity which manages LP 1 is also managed by a CEO. The CEO of the investment management entity is in sum and substance the CEO of the PIV. In view of the above, RoC Delhi held that Mr. Michael Falk is the SBO of Leixir India. Moreover, there is documentary evidence through filings before U.S. Securities and Exchange Commission (SEC) that Mr. Michael Falk is ultimately owning and controlling the investment management entity and is not merely serving in a professional capacity. Therefore, it can be said that he was exercising significant influence or control.

Refer table below to understand the shareholding pattern of Leixir India and its holding companies.



3. Appointment of directors in Leixir India

The filings made by Leixir India do not indicate that some directors were a part of Comvest Group. RoC Delhi also disagreed with the contention that the directors are not nominee director.

Leixir India contended that as per Section 161(3) of the Companies Act, the board may appoint a director nominated only by an institution under any provision of law or agreement with the Central Government or State Government by virtue of its shareholding in the Government company. RoC Delhi held that the argument, that the member of Leixir India is not an institution under Section 161(3) of the Companies Act, is baseless as the term '*institution*' includes a body corporate. In order to further substantiate this point, RoC Delhi pointed out that Form DIR-12 also contemplates 'institution' to include a 'company' as it is clearly stated that "xv *Name of the* ***company*** *or institution whose nominee the appointee is*".

RoC Delhi's interpretation that the term 'company' in Form DIR-12 includes a body corporate or foreign company may be incorrect, as the definition of 'company' in the Companies Act does not encompass foreign companies or foreign body corporate.

RoC Delhi widened the scope of 'significant influence or control' clause and examined the matter from a novel perspective of control exercised through appointment of directors. RoC Delhi levied penalty on the grounds that Leixir India failed to take necessary steps to identify an SBO and to send a notice to the holding company requiring information of the SBO. It is to be noted that sending a notice under Rule 2A of the SBO Rules is a mandatory requirement.

Key Insights

1. **Compulsory issuance of Form BEN-4**: The reporting company should no longer assume it needs to send Form BEN-4 only when it becomes aware or has reasonable cause to believe that an individual is not registered as an SBO with it. According to Rule 2A(2) of the SBO Rules, reporting companies are required to send notices in Form BEN-4 to all their non-individual members holding at least 10% of shares, voting rights, or dividend rights. Additionally, if no SBO is identified based on the 10% threshold, the reporting company must take necessary steps diligently to determine if there is any individual who qualifies as an SBO

of the reporting company to avoid penalties in future. Further, if the objective thresholds are not met, reporting companies must not assume that there is no SBO. It will have to also determine whether or not there is an SBO by applying the subjective test of 'significant influence and control'.

2. **Examine other filings related to SBO or UBO or Beneficial Ownership**: The reporting company should proactively review the filings made with its bank during account opening or for periodic KYC compliance. Additionally, it should review filings related to beneficial ownership or UBO made by the ultimate holding company or PIV in other jurisdictions. If any individual has been declared as the SBO, UBO, or beneficial owner in these filings, the RoC may consider this individual as the SBO of the Indian reporting company and impose fines for non-disclosure.

3. **In the case of PIVs, individual to be nominated as 'SBO'**: RoC through its order in the matter of Leixir India emphasized that the main intent of the provision related to PIVs is to identify an individual who has the ultimate control. In order to arrive at this conclusion, RoC relied on the doctrine of 'purposive construction'. The RoC stated that one needs to understand the purpose or objective behind the text, rather than just focusing on its literal meaning. For deriving the main purpose behind the rule, RoC took into account, the context in which the rule was framed, the problems or the issues the rule aimed to address and the intention of the drafters.

4. **Reporting Channel Test**: Based on the LinkedIn India order, MNCs may need to reevaluate the reporting channel for their CEO or managing director ("**MD**"). Typically, in the case of MNCs, the CEO or MD of an Indian company reports to its board of directors as well as to the regional or global head/CEO. In such cases, it is necessary to examine on a case-by-case basis whether the global head/CEO, while exercising supervision, can be considered the SBO of the reporting company. This becomes all the more relevant when an SBO is not identifiable through the objective thresholds and it becomes relevant to assess who has right to exercise significant influence or control, other than through direct holdings alone. In such cases, actual exercise of influence or control becomes irrelevant and what matters is whether the 'right to exercise' control is established or not.

5. **Financial Control Test**: When financial controls are exercised outside the authority of the reporting company's board, these controls can be viewed as a right to exercise significant influence or control. It is advisable for the board of directors to independently approve financial decisions. If the financial decisions are primarily made outside the board, the board should be seen to have independently reviewed and approved them.

Conclusion

The SBO Rules and proactiveness by the RoCs in evaluating all possible information available mark a significant advancement in corporate governance in India. The identification of SBOs is now a critical compliance requirement that demands proactive efforts from companies and their management for avoid legal and reputational risks. By mandating the identification and declaration of SBO, it aims to enhance transparency, reduce corporate opacity, and foster a more accountable business environment. Identification of SBO is no longer a mere formality, and companies must demonstrate tangible steps taken to identify and disclose SBOs. The stringent penalties and comprehensive compliance requirements underscore the importance the MCA places on these regulations. As companies navigate these rules, the overarching goal remains clear: to unveil the complex web of corporate ownership and ensure that the ultimate controllers of corporate entities are known and accountable. In other words, the master of puppets can no longer remain hidden.