

Significant Beneficial Ownership – A significant compliance challenge for companies



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In recent times, Registrar of Companies (RoCs) have cracked down on several large corporations in relation to compliance with the significant beneficial owners (SBOs) declarations. The article looks at some of the pertinent issues in the context of an order passed by Registrar of Companies (RoC)¹, NCT of Delhi & Haryana in the matter of LinkedIn India and the compliance challenges by it.

Background

The Companies Act, 2013 mandates companies to disclose and maintain a register of their Significant Beneficial Owners (SBOs). The genesis of the concept of ‘significant beneficial ownership’ under Indian law can be traced to the Financial Action Task Force (“FATF”) recommendations on issues pertaining to ‘transparency and beneficial ownership of legal persons and arrangements’, which prescribed every member country to ensure that there is up-to-date information

on beneficial ownership and control of legal persons so as to assess the risks of misuse of legal persons for money laundering or terrorist financing. In this way, the disclosures pertaining to a SBO help to uncover the individuals who ultimately own or control a company. It is important to know this information to prevent the misuse of corporate structures for illicit purposes such as tax evasion, money laundering, and other fraudulent activities.

SBO identification becomes important because *legal ownership* of shares in a company does not always equate to *beneficial ownership* of such shares. Legal title or controlling shareholding may be in the name of an individual or entity who is not the actual beneficial owner, exercising control in the entity, directly or indirectly. The FATF explains that control can also be exercised by informal means (*such as through close personal connections or relatives*).

Thereafter, in 2016, the Company Law Committee (CLC) recommended that companies may be mandated to obtain information on beneficial ownership and maintain a register of beneficial owners. In 2017, the Companies (Amendment) Act was passed to give effect to these recommendations. The underlying rationale behind disclosing SBOs is to gauge the identity of individuals who exercise control over legal persons, but who may not be easy to track due to their names not being mentioned in the companies’ register of members.

Additionally, identifying SBOs helps ensure transparency and good governance and by requiring the reporting of individuals who hold significant control, either directly or indirectly, the Companies Act, 2013 aims to pierce the corporate veil to reveal the actual beneficiaries of corporate actions and profits. This is important for maintaining the financial integrity of the company by having a clear picture of the *ownership* and control structure of the said company.

Legal Framework

In India, SBOs are governed by Section 90 of Companies Act, 2013, read with the Companies (Significant Beneficial Owners) Rules, 2018 as amended from time to time (‘SBO Rules’). Section 90 read with SBO Rules, prescribes twin tests to determine the ‘significant beneficial owner’ of a reporting Indian company. The first is the objective test, which determines an individual’s status basis their percentage shareholding at the reporting Indian company level and majority holding through the ownership chain. The second is the subjective test i.e., determining whether the person has the right to exercise or actually exercising ‘significant influence’ or ‘control’ in any manner, other than merely through direct holding.

Section 90(1) of the Act prescribes the ‘significant beneficial ownership’ threshold at **25%**, while Rule 2(1)(h) of the SBO Rules reduces it to **10%**. This leads to a potential conflict related to the threshold at which ‘significant beneficial ownership’ would be triggered under the Companies Act and the SBO Rules.

It is pertinent to note that a right or entitlement for the purposes of SBO analysis may also be held indirectly, for instance, where the member of the reporting company is a body corporate and the individual holds a *majority stake* in the body corporate (or its ultimate holding company).

Further, a twin-test is laid out under the law, taking into account both *objective* and *subjective* analysis of SBO. Under the *objective* test, the RoC looks at the shareholding of the individual in question and whether he/she indirectly (or together with direct holdings) holds not less than 10% of the shares. Under the *subjective* test, the RoC looks at whether the individual in question has the right to exercise, or actually exercises significant influence or control in any

manner, other than through direct holdings.

Whose responsibility it is to make the SBO declaration

Under the Companies Act, 2013 read with the SBO rules, the primary responsibility lies on the individual who holds or acquires significant beneficial interest to make the declaration to the company. The Companies Act, 2013 also prescribes that the company must maintain a register of such individuals who have made declarations in this regard with the company. Further, every company maintaining such a register is also required to file details of SBOs with the registrar.

The law also imposes a secondary responsibility on the company to take necessary steps to *identify* an SBO and *require* him/her to comply with the above requirements. A company shall give notice to any such individual whom the company knows or has reason to believe is an SBO, has or is likely to have knowledge of an SBO or has been an SBO in the preceding three years. Such an individual must reply to the notice within 30 days, and if they fail to do so or provide unsatisfactory information, the company is required to approach the NCLT with a request to restrict the right of transfer of the SBO's shares or even suspend all rights attached to such shares.

Enforcement action in the matter of LinkedIn India

The RoC recently penalized LinkedIn Technology Information Private Limited ('LinkedIn India') and its directors for failing to disclose their SBOs as required under the Companies Act, 2013 read with the SBO Rules. The RoC also went a step further and imposed penalties on the CEO of Microsoft Corporation (ultimate holding company of LinkedIn India) ('Microsoft'), Mr. Satya Nadella and CEO of LinkedIn Corporation USA ('LinkedIn USA'), Mr. Ryan Rolansky.

The order is of substantial importance to companies operating in India whose ultimate holding companies are based abroad. Here, the RoC based its findings primarily on sub-clause (iv) of clause (h) of Rule 2(1) of the SBO Rules, which provides that an SBO includes an individual who has the right to exercise, or actually exercises, significant influence or control, in any manner other than through direct holdings alone.

The RoC relied on 3 main factors to identify SBOs; the nature of the relationship between LinkedIn India and holding companies ('holding-subsidary test')²⁰, the nature of the reporting channels ('reporting channel test')²¹ and the nature of financial control ('financial control test')²² exercised over LinkedIn India.

LinkedIn India had disclosed LinkedIn USA as its holding company in its financial statements, despite LinkedIn USA not having any upstream shareholding in the shareholding pattern of LinkedIn India. LinkedIn USA and LinkedIn India are both subsidiaries of the Microsoft Corporation. Upon noting this, the RoC concluded that the only way LinkedIn USA could be regarded as the holding company of LinkedIn India, without any direct or indirect shareholding, is if it exercised control over the Board of Directors ('BoD') of LinkedIn India.

Accordingly, under this holding-subsidary test, it concluded that Mr. Ryan Rolansky, being the CEO of LinkedIn USA, holds the right to exercise this control over the BoD of LinkedIn India and is therefore liable to be disclosed as an SBO. It further relied on annual filings of Microsoft with the US SEC to find that Mr. Ryan Rolansky is a part of the senior leadership of Microsoft and ultimately reports to Mr. Satya Nadella, CEO of Microsoft Corporation. On this basis, the RoC concluded that Mr. Satya Nadella is also liable to be disclosed as an SBO of LinkedIn India.

Second, under the reporting-channel test, the RoC examined the executive structure of LinkedIn India and that of its holding and group companies. It found that the BoD of LinkedIn India were appointed from a pool of Microsoft employees worldwide. It concluded that the individuals appointed were Microsoft's '*nominees*' on the board of LinkedIn India, despite LinkedIn India vehemently contesting the same. The RoC examined the Bye-Laws of Microsoft and found that Mr. Satya Nadella, as CEO and Chairman, had general charge and was responsible for the supervision of the business. Accordingly, the RoC found that majority of directors of LinkedIn India are employees of the Microsoft or LinkedIn Group who ultimately reported to Mr. Ryan Rolansky and Mr. Satya Nadella.

Lastly, under the financial control test, the RoC noted that related party transactions were being carried out by the LinkedIn India on behalf of some other group entities and vice versa. In view of the above facts, the RoC imposed a cumulative penalty of INR 27 Lakhs on LinkedIn India, its directors and Mr. Ryan Rolansky and Mr. Satya Nadella.

Analysis

The RoC examined the case by taking the control/significant influence route under SBO Rules. The RoC relied on 3 main factors to identify SBOs; the nature of the relationship between LinkedIn India and holding companies ('holding-subsidary test')²⁰, the nature of the reporting channels ('reporting channel test') and the nature of financial control ('financial control test')²² exercised over LinkedIn India.

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However, to hold that Mr. Satya Nadella and Mr. Ryan Rolansky exercised control over LinkedIn India, it had to be established that they independently had 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. In terms of '*significant influence*,' it had to be established that Mr. Nadella and Mr. Rolansky had the power to participate, directly or indirectly, in the financial and operating policy decisions of LinkedIn India.

The ROC's interpretation of provisions under Section 90 of the Companies Act to identify the two CEOs as SBO in LinkedIn India is not in line with the objective witnessed in the Companies Law Committee report and FATF recommendations. On the contrary, the intention rather appears to be the inclusion of the CEOs of the professionally managed group companies under the ambit of SBO. *Secondly*, the ROC concluded that the directors of LinkedIn India in their capacity as officers of LinkedIn Corporation are reporting to the CEO of the latter and at the same time, being the employees of both Microsoft Corporation and LinkedIn Corporation, are acting as nominee directors in LinkedIn India. However, as per section 166 of the Companies Act, the directors of a company are duty bound to exercise an independent judgement in their duties and to act in good faith for the benefit of the company.

Conclusion

The ROC's interpretation to include global CEOs of professionally managed group companies would result in a situation where Indian subsidiaries having a CEO at group company level would be considered as SBO in relation to its Indian subsidiary that runs counter to the very object of the SBO declaration and identification. The RoC in the extant order examined the extreme end of the reporting structure of LinkedIn India by questioning the slightest gaps possible. Is this what was the spirit of the regulation on significant beneficial ownership is a question regulators may likely need to examine.

¹ Order for Penalty for Violation under Section 89 and Section 90 of the Companies Act, 2013 in the Matter of LinkedIn Technology Information Private Limited, No. ROC/D/Adj/Order/Section 89&90/2246- 2256, dated 22 May 2024