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"SBO AND DEMAT OF SECURITIES – NEED OF THE HOUR" BOMBAY CHARTERED ACCOUNTANTS' SOCIETY – JANUARY 16, 2024

SUDHAKAR SARASWATULA

CHIEF CONSULTANT – MEHTA & MEHTA (CORPORATE LAW FIRM)

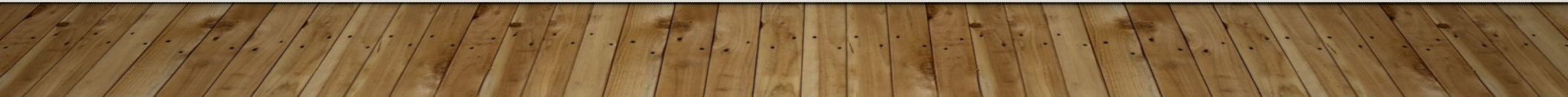
FORMER VICE-PRESIDENT (CORPORATE SECRETARIAL) - RELIANCE INDUSTRIES LIMITED

MOB – 9967651570 / 8149499099

SUDHAKARCACS@OUTLOOK.COM

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LLP SIGNIFICANT BENEFICIAL OWNERSHIP



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OBJECTIVES OF THE SBO PROVISIONS

- SBO provisions are enacted **to identify the individual**, who directly or indirectly, **holds beneficial interest over the entity**
- The entities are owned through a **complex web of holdings and cross holdings**, such that in most cases, the **ownership of the entities is opaque** to uncover such intricate networks of holdings and cross holdings
- **Artificial legal entities are often used for illicit purposes** including global crime such as money laundering, tax evasion and such other activities
- The idea is **to uncover the intricate networks of holdings and cross holdings**, a practice commonly employed to hide the identity of the individual (s) actually owning an entity
- It is important **to ensure transparency and accountability** by identifying and disclosing such individuals and hold them accountable and responsible

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In the year 2018 the concept of 'Significant Beneficial Ownership' was introduced under the Companies Act, 2013 under section 90, in addition to Beneficial Ownership provisions under section 89. The same have been extended to LLPs vide MCA notification dated February 11, 2022. The rationale behind this extension is to align the framework for identification of SBO's of LLPs with that of companies

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LLP (SBO) RULES, 2023

- Limited Liability Partnership (Significant Beneficial Owners) Rules, 2023 were **notified on November 9, 2023**
- The provisions of LLP SBO Rules are **more or less, on similar lines to that of companies** under the Companies Act, 2013
- However, the **difference is mostly in terms of the manner of determining the SBOs** in case of LLPs. It is calculated based on
 - holding of **capital contribution** (shares in case of companies),
 - **voting rights** in respect of management or policy decisions of LLP (shares in case of companies) and
 - right to receive or participate in **distributable profits** (dividend in case of companies)

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Some Key Definitions

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CONTROL

- “control” shall include the
 - right to appoint majority of the designated partners 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 contribution or management rights or limited liability partnership agreements or other agreements or in any other manner;



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MAJORITY STAKE

- “Majority stake” means;-
 - (i) holding more than **one-half of the equity share capital** in the body corporate; or
 - (ii) holding more than **one-half of the contribution** in a partnership entity; or
 - (iii) holding more than **one-half of the voting rights** in the body corporate; or
 - (iv) having the **right to receive or participate in more than one-half of the distributable dividend or distributable profits** or any other distribution by the body corporate including a partnership entity as the case may be

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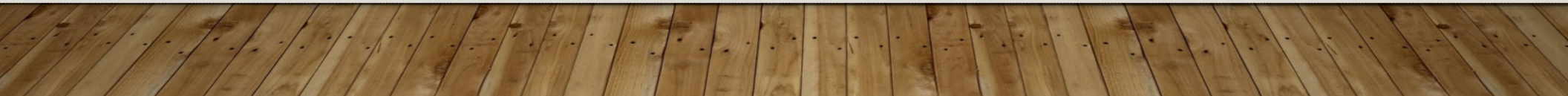
PARTNERSHIP ENTITY

- “partnership entity” means a partnership firm registered under the Indian Partnership Act, 1932 (9 of 1932) or a limited liability partnership registered under the Act;
- “reporting limited liability partnership” means a limited liability partnership required to comply with the requirements of section 90 of the Companies Act, 2013 as modified by the notification

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SIGNIFICANT BENEFICIAL OWNER

- "significant beneficial owner" in relation to a reporting LLP, means **an individual** who acting alone or together or through one or more persons or trust, possesses one or more of the following rights or entitlements in such reporting limited liability partnership, namely:-
 - (i) **holds indirectly** or together with any direct holdings, not less than **ten per cent of the contribution**;
 - (ii) **holds indirectly** or together with any direct holdings, not less than **ten percent of voting rights** in respect of the management or policy decisions in such limited liability partnership;
 - (iii) has right to receive or participate in not less than **ten per cent of the total distributable profits**, or any other distribution, in a financial year **through indirect holdings** alone or together with any direct holdings;
 - (iv) has right to exercise or actually **exercises, significant influence or control**, in any manner other than **through direct-holdings** alone:



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ACTING TOGETHER

- **Explanation V.**- For the purpose of this clause, if any individual, or individuals
 - acting through any person or trust,
 - act with a **common intent or purpose** of exercising any rights or entitlements, or
 - **exercising control or significant influence**, over a reporting LLP, pursuant to an agreement or understanding, formal or informal,
 - such individual, or individuals, acting through any person or trust, as the case may be, **shall be deemed to be "acting together"**

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SIGNIFICANT INFLUENCE

- "significant influence" means
 - the power to participate, directly or indirectly,
 - in the financial and operating policy decisions of the reporting limited liability partnership
 - but is not control or joint control of those policies

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NOT A SIGNIFICANT BENEFICIAL OWNER

- Explanation I.- For the purpose of this clause, if **an individual does not hold any right or entitlement indirectly** under sub-clauses (i), (ii), (iii) or (iv), he **shall not be considered to be a significant beneficial owner.**
- The above means that **if a person hold directly** even more than ten per cent contribution or voting rights or total distributable profits or any other distribution, **he is not an SBO**
- Hence no SBO declaration is required
- However, if he holds even a single rupee contribution, voting right or any distribution indirectly he becomes a SBO and has to file declaration

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HOLDING RIGHT OR ENTITLEMENT DIRECTLY

- Explanation II.- For the purpose of this clause, **an individual shall be considered to hold a right or entitlement directly** in the reporting limited liability partnership, **if he satisfies any of the following criteria, namely:-**
 - (i) **the contribution** in the reporting limited liability partnership representing such right or entitlement are **held in the name of the individual**;
 - (ii) the **individual holds or acquires a beneficial interest** in the contribution of the reporting limited liability partnership under sub-rule (2) of rule 22B of the Limited Liability Partnership Rules, 2009 **and has made a declaration in this regard to the reporting limited liability partnership.**

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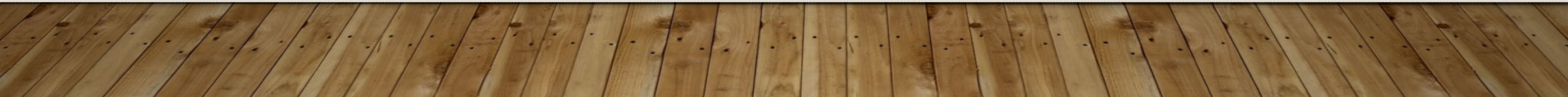
PARTNER IS A BODY CORPORATE

- Explanation III.- For the purpose of this clause, an individual shall be considered to hold a right or entitlement indirectly in the reporting LLP, if he satisfies any of the following criteria, in respect of a partner of the reporting limited liability partnership, namely: -
 - (i) where the partner of the reporting LLP is a body corporate (whether incorporated or registered in India or abroad) other than a limited liability partnership, and the individual,-
 - (a) holds majority stake in that partner; or
 - (b) holds majority stake in the ultimate holding company (whether incorporated or registered in India or abroad) of that partner;

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PARTNER IS A HUF

- (ii) where the partner of the reporting LLP is a Hindu undivided family (through karta), and the individual is the **karta of the Hindu undivided family**;



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PARTNER IS A PARTNERSHIP ENTITY

- (iii) where the partner of the reporting LLP is a partnership entity (through itself or a partner), **and the individual, who-**
 - (a) is a partner; or
 - (b) holds majority stake in the body corporate which is a partner of the partnership entity; or
 - (c) holds majority stake in the ultimate holding company of the body corporate which is a partner of the partnership entity
- In the above case all partners irrespective of their profit-sharing ratio, shall become the SBOs and have to give declaration accordingly

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PARTNER IS A TRUST

- (iv) where the partner of the reporting limited liability partnership is a trust (through 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**;
 - (c) is the author or settlor in case of a **revocable trust**

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TYPES OF TRUSTS

- **DISCRETIONARY TRUST**

- a trust in which the number of shares of each beneficiary are not fixed by the settlor in the trust deed, but at the discretion of the trustees
- where the individual shares of the beneficiaries are indeterminate.

- **SPECIFIC TRUST**

- where the individual shares of the beneficiaries are determinate

- **REVOCABLE TRUST**

- in which your assets are placed into a trust for your benefit during your lifetime and then transferred to the designated beneficiaries at your death by your chosen representative, called a "successor trustee"



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PARTNER IS A POOLED INVESTMENT VEHICLE

- (v) where the **partner of the reporting LLP is,-**
 - (a) **a pooled investment vehicle**; or
 - (b) **an entity controlled by the pooled investment vehicle**, based in member State of the Financial Action Task Force on Money Laundering and the regulator of the securities market in such member State is a member of the International Organisation of Securities Commissions, and the individual in relation to the pooled investment vehicle,-
 - (A) is a general partner; or
 - (B) is an investment manager; or
 - (C) is a chief executive officer where the investment manager of such pooled vehicle is a body corporate or a partnership entity

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PARTNER IS A POOLED INVESTMENT VEHICLE

- Explanation IV - **Where the partner** of a reporting limited liability partnership is,
 - (i) a pooled investment vehicle; or
 - (ii) an entity controlled by the pooled investment vehicle,
- Such pooled investment vehicle is based in a jurisdiction which does not fulfil the requirements referred to in clause (v) of Explanation III, the provisions of clause (i) or clause (ii) or clause (iii) or clause (iv) of Explanation III, as the case may be, shall apply.

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Compliances

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DUTY OF THE REPORTING LLP – RULE 4

- (1) Every reporting LLP shall take necessary steps to **find out if there is any individual who is a significant beneficial owner**, in relation to that reporting LLP, and if so, identify him and **cause such individual to make a declaration in Form No. LLP BEN-1**
- (2) Without prejudice to sub-rule (1), every reporting LLP shall in all cases **where its partner (other than an individual), holds not less than ten per cent.** of its-
 - (a) contribution; or (b) voting rights; or (c) right to receive or participate in the distributable profits or any other distribution payable in a financial year,
 - **give notice to such partner in Form No. LLP BEN-4**, seeking information in accordance with sub-section (5) of section 90 of the Companies Act, 2013 as applied to the limited liability partnership as per the notification

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DECLARATION OF SBO – RULE - 5

- (1) Every individual who is a SBO in a reporting limited liability partnership, shall file a declaration in Form No. LLP BEN-1 to the reporting LLP within ninety days from the commencement of the Rules
- (2) Every individual, who subsequently becomes a SBO or where his significant beneficial ownership undergoes any change shall file a declaration in Form No. LLP BEN-1 to the reporting LLP, within thirty days of acquiring such significant beneficial ownership or any change therein
- (3) Where an individual becomes an SBO, or where his significant beneficial ownership undergoes any change, within ninety days of the commencement of these rules, it shall be deemed that such individual became the significant beneficial owner or any change therein happened on the date of expiry of ninety days from such commencement, and the period of thirty days for filing will be reckoned accordingly

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FILING OF LLP BEN-2 – RULE - 6

- Upon receipt of declaration under rule 5,
 - the reporting LLP shall file a return in Form No. LLP BEN-2 with the Registrar
 - within a period of thirty days from the date of receipt of such declaration by it,
 - along with the fees as prescribed in the Limited Liability Partnership Rules, 2009

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REGISTER OF SBO – RULE - 7

- (1) The limited LLP shall **maintain a register of significant beneficial owners** in Form No. LLP BEN-3
- (2) The **register shall be open for inspection** during business hours, at such reasonable time of not less than two hours, on every working day as may be decided by limited liability partnership agreement, or by partners of the limited liability partnership
 - on payment of such fee as may be specified by the limited liability partnership but not exceeding fifty rupees for each inspection

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NOTICE SEEKING INFORMATION ABOUT SBO – RULE - 8

- A limited liability partnership shall give notice in Form No. LLP BEN-4 seeking information in accordance with sub-section (5) of section 90 as applied to the limited liability partnership by the notification

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APPLICATION TO THE TRIBUNAL – RULE - 9

- The reporting LLP shall apply to the Tribunal,
 - (i) **where any person fails to give the information** required by the notice in Form No. LLP BEN-4, within the time specified therein; or
 - (ii) **where the information given is not satisfactory**, under sub-section (7) of section 90 of Companies Act, 2013
- **for order directing that the contribution in question be subject to** such restrictions as Tribunal deems fit, including-
 - (a) **restrictions on the transfer** of interest attached to the contribution in question;
 - (b) **suspension of the right to receive profits** or any other distribution in relation to the contribution in question;
 - (c) **suspension of voting rights** in relation to the contribution in question; (d) any other restriction on all or any of the rights attached with the contribution in question

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NON-APPLICABILITY – RULE - 10

- These **rules shall not apply to** the extent the contribution of the reporting LLP is held by.-
 - (a) the Central Government, State Government or any local authority;
 - (b) (i) a reporting limited liability partnership, or (ii) a body corporate, or (iii) an entity, **controlled by the Central Government or by one or more State Government**, or partly by the Central Government and partly by one or more State Government;
 - (c) an **investment vehicles registered with** and regulated by the Securities and Exchange Board of India, such as mutual funds, alternative investment funds (AIF), Real Estate Investment Trusts (REITs), Infrastructure Investment Trust (InVITs)
 - (d) an **investment vehicles regulated by the** Reserve Bank of India, or the Insurance Regulatory and Development Authority of India, or the Pension Fund Regulatory and Development Authority

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OBLIGATIONS OF THE SBO

- **Initial Disclosure:**

- Every individual who is an SBO in a reporting LLP will be required to file a declaration in Form No. LLP BEN-1 to the reporting LLP within 90 days from November 9, 2023, i.e. by February 7, 2024.

- **Continual Disclosure:**

- Every individual, who subsequently becomes an SBO or where the significant beneficial ownership undergoes any change will be required to file a declaration in Form No. LLP BEN-1 to the reporting LLP, within 30 days of acquiring such significant beneficial ownership or any change therein.

- **Changes in SBO during the transition period:**

- In case an individual becomes an SBO or where his significant beneficial ownership undergoes any change, within 90 days of the commencement of this rules i.e. from November 9, 2023, to February 7, 2024, it shall be deemed that such individual became the SBO or any change therein happened on the date of expiry of 90 days from the date of commencement of this rules, and the period of 30 days for filing will be reckoned accordingly.

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OBLIGATIONS OF THE LLP

- **Identification of the SBO:**
 - Every reporting LLP will be required to **take necessary steps to find out if there is any individual who is an SBO** in relation to that LLP and if so, identify him and cause such individual to make a declaration in Form No. LLP BEN-1.
 - File LLP BEN-2 on receipt of LLP BEN-1 within 30 days of receipt
 - Reporting LLP will be required to **give notice to a partner** (other than an individual), who holds not less than ten percent of its contribution or voting rights or right to receive or participate in the distributable profits or any other distribution payable in a financial year **in Form No. LLP BEN-4** seeking information where it knows or believes such person: Is an SBO of the LLP;

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DEMATERIALIZATION OF SECURITIES



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SECURITIES TO BE ISSUED IN DEMATERIALIZED FORM

- According to Section 29 of the Companies Act, 2013 public offer of securities shall be in dematerialized form only
- According to this section the following companies shall issue securities only dematerialized form
 - every company making public offer and
 - such other class or classes of public companies as may be prescribed
- In view of the above this section could not be extended to private companies

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PROPOSED AMENDMENT TO SECTION 29

- By the Companies (Amendment) Act, 2019 **the word “public” from sub-section (1) (b) was omitted.**
- With this it will read as
 - such other class or classes of companies as may be prescribed
- In addition to the above the **following proviso was also inserted** to section 29(1)
 - “Provided that in such class or classes of unlisted companies as may be prescribed, the securities **shall be held or transferred only in dematerialized form** in the manner laid down in the Depositories Act, 1996 and the regulations made thereunder for such dematerialization
- This means in such companies a holder cannot go for ‘remat’ of the securities

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Holding of shares by Promoters

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HOLDING SECURITIES IN DEMAT MORE – RULE 9

- According to Rule 9 of the Companies (Prospectus and Allotment of Securities) Rules, **Promoters** of a public company **before making a public offer** of any convertible securities shall hold such securities **only in dematerialized form**
- The **entire holding** of convertible securities by the promoters till the date of IPO **shall be converted into dematerialized form** before such offer is made
- After the IPO the promoter shall hold the securities in demat form only and they **can't get the shares re-matted**

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Issue of securities by unlisted public companies

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ISSUE OF SECURITIES BY UNLISTED PUBLIC COS – RULE 9A

- 1) Effective October 2, 2018, Rule 9A was inserted according to which every unlisted public company shall
 - issue the securities only in demat form
 - facilitate dematerialization of all its existing securities
- 2) Before the issue or buy-back of any securities entire holding of the promoters, directors, KMPs shall be in demat mode
- 3) Every holder of the securities who intends to transfer shall get the securities dematerialized before such transfer

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SECURITY HOLDERS' OBLIGATION

- Every holder who intends to subscribe to any securities of the unlisted public company by way of private placement or rights or bonus shall ensure that all his existing securities are held in demat mode before such subscription
- While offering securities in buy-back it not necessary for holders other than promoters, directors or KMPs to hold such securities in demat mode (any way those shares are being extinguished)

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Companies (Prospectus and Allotment of Securities) Second Amendment Rules, 2023.

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NOTIFICATION OF THE RULES

- These rules came into force **effective October 27, 2023**
- **A timeline of 18 months is provided** from the closure of the financial year in which a private company is not a small company **for the compliance** with the mandatory dematerialization requirements

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CONVERT PHYSICAL SHARE WARRANTS INTO DEMAT

- Every public company which has issued share warrants prior to commencement of the Companies Act, 2013 and not converted into shares shall, -
 - (a) within a period of three months of the commencement of these Rules, inform the Registrar about the details of such share warrants in Form PAS-7; and
 - (b) within a period of six months of the commencement of the Rules, require the bearers of the share warrants to surrender such warrants to the company and get the shares dematerialized
- company shall place a notice for the bearers of share warrants in Form PAS-8 on the website of the company, if any and shall also publish the same in a newspapers

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SHARE WARRANTS TRANSFER TO IEPF

- In case **any bearer of share warrant does not surrender** the share warrants within the period referred to in sub-rule (2), the **company shall convert the such share warrants into dematerialized form and transfer the same to the Investor Education and Protection Fund** established under section 125 of the Act



Issue of securities in dematerialised form
by private companies

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ISSUE OF SECURITIES BY PRIVATE COMPANY – RULE (9)(2)

- 1) Every private company, other than a small company, shall –
 - (a) issue the securities only in dematerialized form; and
 - (b) facilitate dematerialization of all its securities
- (2) A private company, which as on last day of a financial year, ending on or after 31st March 2023, is not a small company as per the audited financial statements for such financial year, shall, within eighteen months of closure of such financial year, comply with the provisions of this rule

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DEFINITION OF A "SMALL COMPANY"

- Pursuance to section 2(85) of the Companies Act. 2013, a 'small company' means a company other than a public company
 - Paid up capital of which does not exceed four crore rupees or subject to such higher amount as may be prescribed which shall not be more than ten crore rupees and
 - Turnover of which as per the P&L account for the immediately preceding financial year does not exceed forty crore rupees or such higher amount as may be prescribed which shall not be more than one hundred crore rupees
- Provided that nothing in this clause shall apply to – holding or subsidiary company, section 8 company or a company or body corporate governed by any special act

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TIMELINE FOR COMPLAINT

- In case a company ceases to be a small company after 31st March 2023, the timeline of 18 months triggers from the closure of the financial year in which it ceases to be a small company i.e. September 30, 2024
- If a company ceases to be a small company at any time during FY 23-24, the timeline of 18 months will trigger from 31st March 2024 and therefore, shall be complied with by 30th September 2025
- In case a company is not small company as on March 31, 2023, but becomes a small company as on March 31, 2024, how to comply with the provisions
 - Technically the securities have to get dematerialized and thereafter they may be rematerialized

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TRANSFER / SUBSCRIPTION OF SECURITIES

- (3) **such private company shall ensure** that before making any offer, for issue of securities (rights or bonus) or buy-back, entire holding of securities of its promoters, directors, key managerial personnel has been dematerialized
- (4) Every holder of securities of such private company,-
 - (a) **who intends to transfer** such securities on or after the date when the company is required to comply with this rule, **shall get such securities dematerialized** before the transfer; or
 - (b) **who subscribes to any securities** of the concerned private company whether by way of private placement or bonus shares or rights offer on or after the date when the company is required to comply with this rule shall ensure that all his securities are held in dematerialized form before such subscription
- provisions of this rule **shall not apply** in case of a Government company
- provisions of sub-rules (4) to (10) of rule 9A shall, **mutatis mutandis, apply to** the dematerialization of securities under this rule

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PROVISIONS OF SUB-RULES (4) TO (10) OF RULE 9A

- 4) Dematerialization of securities **shall be facilitated by the company** – shall secure ISIN and inform all security holders
- 5) Company shall ensure that it makes **timely payment to the depository and the share transfer agent**, maintain security deposit of not less than two years fee at all times with the depository and share transfer agent and it complies with the regulations or guidelines or circulars of SEBI and Depositories
- 6) in case of any default, such company can't issue or buy-back any securities, till the default is rectified
- 8) company shall file PAS-6 form duly certified by a PCS with the ROC within sixty days from the conclusion of each half year

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PROVISIONS OF SUB-RULES (4) TO (10) OF RULE 9A

- 8A) In case of any difference in the issued capital and dematerialized capital the company shall bring to the notice of the depository
- 9) Grievances if any of the security holders shall be filed before IEPF authority
- 10) IEPF shall initiate action in consultation with SEBI

APPLICABILITY OF RULES

- **Rule 9B**, enforcing mandatory dematerialization of the securities of private companies, **is applicable to all private companies other than the following:**
 - Small company, and
 - Government company
- **Rule 9A extends a similar exemption** from dematerialization requirements **to the following public companies:**
 - Nidhi company,
 - Government company, and
 - **A wholly owned subsidiary.**
- Though under rule 9A, a wholly owned subsidiary of a public company, is exempt from the dematerialization requirements, **similar exemption is not extended to a private company under Rule 9B**
- Hence, **it seems that** a wholly-owned subsidiary, incorporated in the form of a private company, (though a deemed public company) is not exempt from dematerialization requirements

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ACTION POINTS FOR PRIVATE COMPANY

- Issue all securities in dematerialized form only
- Intimate to all securityholders to dematerialize their existing security holdings
- Facilitate dematerialization of all existing securities (as and when request is received from the holder of such securities)
- Ensure that the entire holding of its promoters, directors and KMPs are held in dematerialized form only, prior to making any offer for issuance or buyback of securities

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ACTION POINTS FOR SECURITY HOLDERS

- Dematerialize securities **if you are a promoter, director or KMP** before the company offer or issue any securities
- Dematerialize securities **before subscription** to any securities issued by a private company
- Dematerialize securities, **before proposing transfer** of such securities
- Dematerialize securities **before offering** the securities **in any buy-back** proposal of the company

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PENAL PROVISIONS

- No specific penal provisions were provided for non-compliance with Rule 9B
- Therefore, general penal provisions under section 450 of the Act should apply i.e.
 - liable to a penalty of ten thousand rupees, and
 - in case of continuing contravention, with a further penalty of one thousand rupees for each day after the first during which the contravention continues,
 - subject to a maximum of two lakh rupees in case of a company and fifty thousand rupees in case of an officer who is in default or any other person

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THANK YOU