

How to effectively disclose corporate ownership and control structures up to beneficial owners¹

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1. Introduction: How to fill the gap?

Currently, within the EU law there is no guidance which could provide content to the definitions of beneficial ownership interest, control and ownership structure or persons with (direct or indirect) control or provisions which could describe the process of identification and evidencing of ownership structure of a legal person. This shortcoming can be to certain extent remedied by provisions employed in the recommendations of the intergovernmental organisation Financial Action Task Force, in particular Recommendations 24³ and 25⁴ and the FATF Guide - Transparency and Beneficial Ownership⁵. Financial Action Task Force which exists as of 1989

¹ This contribution is a follow-up to the project of Centre of Economic Studies of University of Economics and Management.

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³ Recommendation 24 –Transparency and beneficial ownership of legal persons.

⁴ Recommendation 25 –Transparency and beneficial ownership of legal arrangements.

⁵ FATF Guidance, Transparency and Beneficial Ownership, FATF, October 2014.

represents a specialised international organisation in the area of prevention of money laundering and financing of terrorism, including ownership structures and beneficial owners.

Although the FATF guidance on transparency of beneficial ownership interpreting FATF Recommendations 24 and 25 is a solid basis for the desired converging interpretation of the existing general legal notions in the area of disclosure and evidencing of ownership structures and beneficial owners, it is still not detailed enough to serve as a practical step-by-step guide either for legal persons or responsible authorities in this context. This step-by-step guide providing guidance on the key definitions and the process of identification and evidencing of beneficial ownership interest is provided by the Practical Guide on disclosure and evidencing of corporate and control structures and beneficial owner(s) (the Practical Guide)⁶ developed by Czech non-governmental organisations. This Practical Guide is largely inspired by the aforementioned FATF Recommendations and Guidelines. It is, however, more specific than the FATF documents, practically applicable both for public authorities and legal persons and usable for all types of ownership structures irrespective of the jurisdiction to which these structures could lead to.

The Practical Guide is divided in four parts: after the definitions of the main terms in the first part, the second parts lays down the contents of the declaration on corporate ownership structure and beneficial owners while the third part sets out the requirements for evidencing documents by which the information on legal persons and other entities and ownership interest can be proven. The last four parts adds rules on updating the disclosed and evidenced ownership structures.

2. Identification of corporate and control structure up to beneficial owner(s)

The Practical Guide satisfies the need for a converging guidance of the terms relating to ownership structure disclosure found in the aforementioned different pieces of EU legislation, such as the Directive 2015/849, Directive 2014/24, Regulations 966/2012 and 1268/2012 or Regulation 2001/2580.⁷ A converging interpretation can be provided thanks to the common

⁶ Transparency International Czech Republic and Lexperanto: www.transparencyid.com

⁷ Arts. 13 (1) (b), (d) and Art. 30 (1), (2) and (4) Dir 2015/849; Art. 51 (1) Dir 2014/24; Art. 106 (4) and (10) and Art. 143 (2) Reg 966/2012 and 1268/2012; Art. 1 (5) and (6) Reg 2001/2580.

purpose of rules on anti-money laundering and terrorism financing, on the one hand, and prevention of corruption, conflict-of-interest, financing of criminal activities and activities of individuals, organisations or States subject to economic sanctions, which is to prevent that both private and public funds do not fuel organised crime, misuse of taxpayers' money and activities of belligerent states and organisations. Hence, the Practical Guide provides definitions of ownership structure, interest (direct and indirect), control and controlling persons.

Then the contents of the declaration on corporate ownership structure and beneficial owner are laid down. Its aim is to establish which information and evidence should be required from each person within the control and corporate structure. The ownership structure is composed of two elements: legal persons and other arrangements on the one hand – grouped under a common term corporate subjects - and ownership interest on the other hand. Corporate subjects in the ownership structure can be either business corporations, such as limited liability companies, non-profit legal persons, such as associations or foundations, or trust-like or fund-like structures, such as trusts or funds. Ownership interests, *i.e.* the relationship what joins together the corporate subjects, can be either interests of 25 % plus one share as defined in Directive 2015/849, or interests of 25 % and less.

A beneficial owner may be either a natural person or an ultimate public organisation. The ultimate public organisation shall mean a public law entity, such as an international organisation, state, regional, municipal, local organisation or other self-regulatory body, in which no other legal entity or arrangement has a interest or other relevant interest. The ultimate public organisation may be an international organisation, state, territorial administrative unit, professional chamber, e.g. bar association, or autonomous public institution, e.g. university.

Identification of corporate subjects in the ownership structure and beneficial owners is not sufficient. Neither the obliged entities nor public registers of beneficial owners under Directive 2015/849 can content themselves with mere declarations of honour on who the beneficial owners are and what the nature and extent of their direct or indirect beneficial interest is. The requirement of evidencing of ownership structure and beneficial owners results from Art. 30 (4) of Directive 2015/849 which prescribes that the information about beneficial owners and their interests held in central register have to be adequate, accurate and current; its recital 14

stipulates that Member States may decide that obliged entities are responsible for filling in the register, the disclosure of the nature and extent of direct and indirect beneficial interest of beneficial owners will have to be evidenced.

3. Evidencing of corporate and control structure up to beneficial owner(s)

If any guidance on disclosure of corporate structure and beneficial owners is to have any value, it has to specify by which documents the information on ownership structure, including the evidence of entities within this structure and interests, and beneficial owners, should be evidenced. The existence of a legal person, including the information about its name, registration number, address and its management or supervisory body, can always be proven by an excerpt from a public registry. No legal person can exist without being registered in a public registry. The interest in legal persons, which laws of most countries qualify as an ownership interest⁸ or a membership right,⁹ is in almost all countries evidenced by a paper document or an electronic record. An ownership interest in a legal person can be evidenced above all by a record from a public registry; however, depending on the type of a legal person such evidence of ownership interest may not always be available.

If the information about an interest is not available in a record from a public registry, an interest in a company can be proven by its shares: if a company has book-entry shares, then the share will be proven by a record from the securities account by the holder of the account who, at the same time, will be owner of the share. By contrast, if a company has registered paper shares, then to evidence the shareholder interest, the list of shareholders accompanied by a copy of the share certificate and a declaration of honour that these copies reflect the originals should be delivered; when a company has paper bearer shares, where the ownership cannot be easily determined, it should put these shares into an irreversible deposit, a de facto immobilisation of such shares since otherwise their owner will not be identifiable. The owner and the ownership of bearer paper shares in irreversible deposit will then be proven by the confirmation from a bank about the fact that these shares were put into such deposit.

⁸ Corporate entities and other arrangements.

⁹ In non-profit legal persons.

Regarding non-profit legal persons, the membership interest therein, or more precisely the membership, will be proven either by a memorandum of association or a list of members. In respect of trust-like or fund-like arrangement the evidence about the interest in such an arrangement will be proven by a notarial deed establishing such arrangement and a copy of the list of beneficiaries.

In the context of evidencing interest in legal persons and other arrangements, the difficulty may appear in situations where it will be necessary to evidence an interest in a legal person or trust-like or fund-like arrangements which will be incorporated outside the European Union should be evidenced. Indeed, it may not be easy to verify whether a document issued by a non EU- legal person or a non-EU custodian maintaining a share account or a bank holding paper bearer shares in irreversible deposit. In case of documents issued by non-public entities, that is by a non-EU legal person in the ownership structure or by a non-EU custodian or a bank additional documents should be required: from the non-EU legal person the Practical Guide requires in addition (i) a declaration on confidentiality waiver regarding the relevant securities account or deposit of paper bearer shares, and (ii) an authorisation to obtain information regarding securities account or deposit with the bank which issued the relevant evidencing document. Furthermore, from a non-EU share account custodian or a depository which issued such evidencing document, an undertaking of cooperation with authorities of EU Member States signed by the authorised bank officer should be required in order to make the verification of the evidencing documents submitted by the EU legal person in respect of legal persons and interest within its ownership structure but outside the EU possible.

The last issue which needs to be solved is how to verify whether the beneficial owner who is a natural person is the true or ultimate beneficial owner or whether he or she is only a formal legal beneficial owner who in reality acts on behalf of some other person. If the identified and evidenced ultimate owner is the beneficial owner it should be indicated – in the above-mentioned declaration identifying beneficial owner – whether the ultimate and beneficial owner is a lawyer or a professional nominee. This indication would help trace possible fraud since the situation when the declared ultimate beneficial owner is a lawyer or professional nominee could indicate that the declared ultimate beneficial owner may be acting on behalf of another person: the actual verification of this fact could, however, not be made within the identification and evidencing process but on a case-by-case basis by authorities of Member

States in case of fraud suspicion which would give right to public authorities to lift the lawyer's secrecy. Nevertheless, such a declaration would at least expose the possibly fraudulent lawyer or professional nominee to a violation of ethical rules. Under the other option, with respect to the ultimate formal owner who would be acting on behalf of another person – the beneficial owner – it should be indicated in the aforementioned declaration that such ultimate formal (legal) owner is not a beneficial owner, and at the same time this beneficial owner should be identified together with the identification a contract of representation, power of attorney or other document on the basis of which the ultimate legal owner is acting on behalf of ultimate beneficial owner. This process should be repeated should the indicated beneficial owner be in reality also only a representative acting on behalf of a further person until the moment when the true beneficial owner would be reached.

4. Updating, exemptions and other aspects

Requiring disclosure and evidencing of the ownership structure of legal persons would make little sense if these structures were not regularly updated. Both the ownership structures and beneficial owners can change the next moment after the disclosure has been done. Should the disclosed information about ownership structures and beneficial owners correspond to the reality, they must be updated in a way that they reflect the reality, but at the same time this updating must not be too cumbersome for the legal persons concerned.

Any useful guidance on beneficial ownership disclosure and evidencing must therefore resolve the issue of updating of disclosed ownership structures and beneficial owner(s). The updating has to deal with two situations: first, with a situation when in a certain period no changes in ownership structure took place, and second, with a reverse situation when one or more changes in ownership structures occurred in such period. An effective and at the same time efficient solution of these situations requires a differentiated approach: for situations where no changes occurred less evidence is necessary than for situations where changes did take place. In concrete terms, where during the past calendar quarter, there is a change in ownership of the interest in the corporate subject, then the declaration and evidencing documents should be updated at the end of this calendar quarter. If there are more subsequent changes in the calendar quarter, all these changes should be registered at once at the end of the calendar quarter in question. This means that at a maximum, the ownership structure will

have to be updated four times a year. If during the calendar year no change in the ownership structure happened, the legal person should confirm this fact and provide up-to-date ownership documents to prove it.

The guidance should provide for exemptions from the disclosure and evidencing obligations. In principle, two exemptions can be foreseen. The first one relates to interests acquired on regulated market and multilateral trading facilities subject to disclosure requirements consistent with Union law or subject to equivalent international standards which ensure adequate transparency of ownership information, as set out in the definition of the beneficial owner under Directive 2015/849.¹⁰ The second one is not laid down directly in any legal regulation but results from the EU as well as national prudential rules governing the licensing of financial and credit institutions, insurance companies financial intermediaries, investment and pension funds etc. The ownership structures and beneficial owners not only have to be identified, but are also subject to approval of the relevant regulatory bodies as far as the origin of their initial capital and the credibility of controlling persons is concerned, including their changes.

Last but not least, in respect of identification of more complex structures involving chains of interest holdings, a number of additional more detailed technical issues have to be dealt with: for instance, how persons with controlling interest should be determined, how to identify shareholders acting in concert¹¹ or how circumvention of disclosure and evidencing rules by collateral holders which may effectively control voting rights in a legal person via collateral agreements should be prevented. Control can be established by using threshold approach or majority interest approach. The threshold approach is based on minimum percentage of ownership interest in the legal person¹². This approach is contained in the 2580/2001 Regulation and the corresponding Guidelines which consider a controlling person to be the person holding in a legal person an ownership interest of 50 % + 1 share. Under the majority

¹⁰ Art. 3 (6) Dir 2015/849.

¹¹ Moreover, in another example, as the definition of indirect ownership suggests there can be more than one controlling owner with 25% + 1 share interest, for example, if two 30 % interest owners act jointly and they can outvote the third owner with the highest nominally 40 % interest. in a way that the combined interest of the latter would trump the 40 % shareholder.

¹² FATF Guidance on transparency and beneficial ownership, pt. 33 (a), 15.

interest approach control is not determined on the basis of ownership percentage but on the basis of effective control exercised through any contract, understanding, relationship, intermediary or tiered entity¹³. To determine an owner having control at each level of shareholding interest, both approaches have to be combined to capture situations where the interest of the majority owner does not exceed 50 %, but is still the highest one and ensures control to the majority owner.

5. Conclusion: Effective and efficient solution in the developed Practical Guide

A lack of interpretation of the notions of beneficial ownership interest, ownership and control structure or person with control as well as of the process of disclosure and evidencing of these structures and persons hampers the effectiveness of fighting terrorist financing, corruption in granting of public contracts and subsidies and international sanctions, but also generates unnecessary administrative burden for legal persons concerned. This lack of effectiveness of the beneficial owner disclosure due to the non-existing common EU interpretation of the notion corporate and control structure was demonstrated in the Panama Papers scandal¹⁴. It is therefore understandable that there is a rising pressure from the political level to make sure that registers of beneficial owners contain granular, reliable and up-to date information on beneficial owners and their interests in legal persons.

However, despite this strong political pressure on the creation of registers of beneficial owners which would contain high quality information on beneficial owners and their interests in legal persons which would be easily and widely accessible, the identification and evidencing of ownership structures of legal persons encounters in practice potentially significant difficulties. Clearly, a common EU interpretation guide on what the beneficial ownership interest, corporate and control structure or person with control mean and how should the ownership structure should be disclosed and evidenced would significantly help significantly in the fight

¹³ *Ibid.*, supra fn. 12, pt. 33 (b), 15.

¹⁴ O. Skalková, 'Jedině v české eBance umíme otevřít účet bez uvedení reálného vlastníka, pochvaloval si advokát Mossack Fonseky', 4 April 2016, informační server iHNED, available at: <http://byznys.ihned.cz/c1-65233650-jedine-v-ceske-ebance-umime-otevrit-ucet-bez-uvedeni-realneho-vlastnika-pochvaloval-si-advokat-mossack-fonseca>; O. Skalková, 'Panamské dokumenty ukázaly na eBanku. Otevřou účet bez reálného vlastníka, psal právník', 4 April 2016, informační server Aktuálně, available at: <https://zpravy.aktualne.cz/ekonomika/panamske-dokumenty-ukazaly-na-ebanku/r~7f13e4acfa6d11e5b61c002590604f2e/>

against financing of organised crime and terrorism, corruption, conflict of interest and enforcement of international sanctions.

The desired interpretation guidance in this respect has so far been developed only by non-governmental organisations. Their interpretation guidance contained in the Practical Guide on disclosure and evidencing of corporate and control structures and beneficial owner(s) could, on the one hand, fill in the aforementioned interpretation gap and remedy the described problems; on the other hand, this interpretation guidance could help banks and other non-financial bodies and professions to duly fulfil their duty to identify the corporate ownership and managing control of a client and his beneficial owners under the respective antimoney laundering rules.

The Practical Guide could also help the registry courts not only to verify whether the declared beneficial owner of a legal is indeed the beneficial owner but also to check the amount and extent of his beneficial interest. At the same time, this guide could help public bodies to verify ownership structures until beneficial owners of participants in public procurement tenders and applicants for EU fund providers. This interpretation guidance prepared by NGOs could be turned into an EU legislative proposal foreseen under Directive 2015/849¹⁵ which may be presented until 26 June 2019 by the European Commission together with the Report on assessing the conditions and the technical specifications and procedures for ensuring safe and efficient interconnection of the central registers.

If the aforesaid EU-wide guidance on beneficial ownership was also accompanied by a single EU-wide certification mechanism which would attest that the disclosure and evidencing of ownership structure and beneficial owners was performed in accordance with such guidance, it would alleviate the administrative burden on legal persons required to register their beneficial ownership interest and beneficial owners. At the same time, it would reduce the administrative burden resulting from the obligation to verify those beneficial owners and ownership structures imposed on financial institutions and other designated non-financial bodies and professions as well as public authorities having the same obligations with respect to recipients of public contracts and subsidies.

¹⁵ Art. 30 (10) and Art. 31 (19) Dir 2015/849.

An effective and efficient verification system of beneficial owners and their interests has a value of its own. The more adequate, accurate and current the information will be about the beneficial owner, nature and extent of beneficial interest in those public registers, the better information will the individual persons and organisations that prove legal interest obtain from those public registers under their right stipulated in Article 30 (5) of the Directive 2015/849.

However, solid information on beneficial owners and their interests can also serve the purposes of the fight against tax avoidance as confirmed by conclusions of the Council of Ministers on tax transparency from October 2016 which require the best possible quality of information on beneficial owners in the register of beneficial owner(s).¹⁶ If the beneficial ownership certification mechanism were able also to certify that corporate entities within the ownership structure published their annual financial accounts statement as they are obliged under the Accounting Directive, it would also be possible to determine the overall effective corporate tax rate of companies or group of companies.¹⁷ on that basis it could then be envisaged that a company or group of companies which would had a very low effective tax rate, for example, below ten percent - suggesting that such company or group of companies is engaged in the use of aggressive tax planning practices or tax havens - such company or group of companies could be prevented from accessing public contracts or subsidies either from the EU budget, EU funds or public funds of Member States as required by the Resolution of the European Parliament on corporate tax transparency of December 2015.¹⁸

¹⁶ Pt. 8 of the Conclusions; available at: <http://www.consilium.europa.eu/en/press/press-releases/2016/10/11-ecofin-conclusions-tax-transparency/>

¹⁷ Transparency International Czech Republic and Lexperanto: www.taxparentmark.eu

¹⁸ Recommendation C.3. of the Resolution of the European Parliament “Bringing transparency, coordination and convergence to corporate tax policies” European Parliament resolution of 16 December 2015 with recommendations to the Commission on bringing transparency, coordination and convergence to corporate tax policies in the Union (2015/2010(INL)).