SQUIRE PATTON BOGGS

Family Office Insights
UK Register of Beneficial Owners – The Details

In April 2017, a call for evidence issued by the UK government introduced the concept of a register of beneficial owners of non-UK corporates, aimed at improving transparency in the UK real estate market.

Evidence has been gathered, consultations made and now in July 2018, the Department for Business, Energy & Industrial Strategy has published the draft legislation that would implement this register – the Registration of Overseas Entities Bill – and it is very much in the form trailed over a year ago. The bill is subject to technical consultation, but if enacted in its current form, will impose a fairly significant compliance burden on affected entities.

Who Will Have to Register?

The Registration of Overseas Entities Bill, as the name suggests, will not only catch companies. An "Overseas Entity" will include any body corporate, partnership or other entity that is a legal person under the law by which it is governed. Any Overseas Entity may apply to be entered on the new register, but there will be little benefit to registering an Overseas Entity that does not own a relevant interest in land. Entities that do own land in the UK will have an 18-month window to apply for entry on the new register or dispose of the land, and will commit an offence if they fail to do either.

Who Are Beneficial Owners?

An Overseas Entity that applies for registration will have to provide information about its beneficial owner or owners, which are defined in very similar terms to the "people with significant control," which UK companies are required to disclose already. A person will be regarded as a "beneficial owner" for the purposes of the new register if:

- They hold more than 25% of the shares in an Overseas Entity (whether directly or indirectly)
- They hold more than 25% of the voting rights in an Overseas Entity (whether directly or indirectly)
- They directly or indirectly hold the power to appoint or remove a majority of the board of directors of the Overseas Entity
- They otherwise have the right to exercise, or actually exercise, significant influence or control over the Overseas Entity, or
- They have the right to exercise, or actually exercise, significant influence or control over a trust or firm that is not a legal entity which meets one of the four conditions mentioned above

As an anti-avoidance measure, persons who hold shares or rights in a "joint arrangement" will each be regarded as holding all the shares or rights that are in that arrangement.

A "joint arrangement" is an arrangement, whether formal or not, but having at least some degree of stability about it, that the parties to it will deal with their shares or rights in a pre-arranged way. That would mean, for example, that a married couple who each own 20% of the shares in an Overseas Entity, and who informally agree always to vote the same way, will each be regarded as owning 40% of the shares and will each be a beneficial owner.

What Details Will Be Held on the Register?

In order to be registered, an Overseas Entity will need to declare to Companies House whether it has any beneficial owners, together with details of those beneficial owners, which include their name, nationality, country where they usually reside, address for service, the nature of their control over the entity and the date on which that control began. These details will, subject to the comments below, be in the public domain. Additionally, the register will hold the beneficial owner's date of birth and usual residential address, but these will not be publicly accessible.

If an Overseas Entity declares that it does not have any reasonable cause to believe that it has any beneficial owners, in order to be registered, it will instead need to provide the same information for its managing officers (which includes a director, manager or secretary), as an entity would have to provide for its beneficial owners. It will also be possible for an Overseas Entity to declare that it has reason to believe that it has at least one beneficial owner that it has not identified, and that it cannot provide the required information in respect of. In this situation, the Overseas Entity must provide the required information for all its beneficial owners that it can identify, and for its managing officers.

Before making an application for registration, an Overseas Entity will have to take reasonable steps to identify its beneficial owners and to obtain the required information about them. These reasonable steps must include serving an information notice on any person that the entity knows, or has reasonable cause to believe, is a beneficial owner. That notice must ask the recipient to confirm if they are a beneficial owner, and if so to confirm that any required information about themselves set out in the notice is accurate, and to correct and provide missing information as necessary.

The bill provides that the Secretary of State may make regulations in respect of what information, which would otherwise be in the public domain, should be kept confidential. The guidance gives the example of a beneficial owner who may be at risk of physical harm if his or her identity were known.

Annual Updating Will Be Required

Once on the register, the Overseas Entity must provide an annual update of the information submitted to Companies House, and before doing so, the information notice procedure will need to be undertaken again. While there will be exemptions for any beneficial owners whose details are already registered elsewhere (e.g., a UK company that is already covered by the register of persons with significant control), for most Overseas Entities, the new law will introduce a new compliance obligation that could, for more complex holding structures, be quite onerous.

Restriction on Dealing With Land

Once the legislation comes into effect, the Land Registry will be required to enter a restriction on every registered title relating to real estate owned by an Overseas Entity. This will include both residential and commercial properties and both freehold and leasehold interests (although, it will exclude leases of fewer than seven years, as these are not registrable). The restriction will effectively make it impossible for unregistered Overseas Entities to deal with real estate in a legally binding manner, by prohibiting the transfer or charge of the affected property, or the grant of a lease of it for more than seven years, unless the Overseas Entity has been registered on the new register or is exempt from registration. For titles that are already owned by an Overseas Entity at the date the legislation comes into effect, the effect of the restriction will be deferred for 18 months (so giving the entity the opportunity to dispose of the property if it would prefer not to register).

Sanctions for Non-Compliance

New criminal offences are also being introduced by the bill. Overseas Entities and their managing officers will commit offences if they:

- Fail to comply with the annual updating obligation
- Deliver any document to Companies House that is misleading, false or deceptive in a material particular
- Make any statement to Companies House that is misleading, false or deceptive in a material particular
- Fail to register the Overseas Entity within 18 months of the bill coming into effect (if they already own land in the UK), or if ordered to do so by the Secretary of State, or
- Make a disposition of land that is prohibited by a restriction on the title

It will also be an offence not to comply with an information notice.

These offences will carry fines or, in all cases other than the failure to comply with annual updating obligations, possibly prison sentences of up to 12 months (or even up to five years in the case of disposing of land when that is prohibited).

Limited Exceptions

The bill does provide limited exceptions to the obligations to register and from the definition of beneficial owner. The Secretary of State has the power to exempt an Overseas Entity or a particular beneficial owner from the registration requirement – guidance suggests that this would mainly be applicable to entities and persons already subject to similar registration elsewhere.

An important exception is also made for limited partnerships, which are most commonly used as vehicles for investment in commercial real estate. To reflect the fact that limited partners in such partnerships are barred from participating in their management, limited partners will not be regarded as beneficial owners under the first three tests set out above (that is, ownership of shares, voting rights or rights to appoint directors) merely because they are limited partners.

Practical Example

To illustrate the effect of the draft bill, consider PropCo, a company incorporated in the Offshore Islands. PropCo has a single shareholder, Mr. Ecks, and its officers are two professional directors resident in the Offshore Islands. Company registration in the Offshore Islands is confidential, so members of the public cannot find out that Mr. Ecks is the shareholder. PropCo owns a freehold residential property in London, 1 Acacia Avenue, which is registered at the Land Registry.

If the bill comes into effect, the Land Registry will place a restriction on the title to 1 Acacia Avenue, deferred for 18 months, stating that a disposition of the property is prohibited unless PropCo is registered on the Overseas Entity register. The directors of PropCo, knowing that Mr. Ecks is the sole shareholder, have reason to believe he is a beneficial owner of the company, so serve him with an information notice. He provides the details required by that notice and with that information, the directors apply to register PropCo on the new register. Having done so, PropCo will be able to deal with the property in the future. The directors will have to repeat the information notice procedure annually and provide an update to the register.

The effect is that whereas today it is impossible for an interested person to find out who benefits from PropCo owning 1 Acacia Avenue, in the future, it will be a matter of public record that it is Mr. Ecks who does so.

Potential Weaknesses

Whilst the greater transparency that the new law would introduce is a welcome step in curbing the use of UK real estate for money laundering, there are sufficient weaknesses in the proposed bill to mean that it will be no silver bullet – and, in fact, if it creates false confidence that criminals are being deterred, it may be counterproductive. What are these weaknesses?

Consider the case of PropCo above, and assume that the Offshore Islands directors are honest, professional and competent and want nothing to do with criminal activity. They investigated Mr. Ecks when he set up PropCo and checked his identity thoroughly – he is a citizen of Onshoreland. They also established that he has a chain of restaurants in Onshoreland that generate the funds to buy 1 Acacia Avenue. So when they serve Mr. Ecks with the information notice, they are not surprised when he confirms that he is the beneficial owner.

However, Mr. Ecks has not been honest with the directors. His restaurants are, in fact, a front for criminal activity by Mr. Krook, and it is Mr. Krook's proceeds of crime, which are being used to buy 1 Acacia Avenue. Mr. Ecks has provided false information in reply the information notice. The Overseas Entity register will not show the true beneficial owner.

A more sophisticated situation would be if Mr. Ecks were not the sole shareholder, but instead one of five shareholders, each of whom owned 20% of the shares. These shareholders all appear to be independent businessmen, and the Offshore Islands directors had satisfactory ID and source of wealth information for them all. The directors serve all the shareholders with information notices and the shareholders confirm they do not have a joint arrangement in relation to the shares. In these circumstances, the directors' duty would be to register PropCo as having no beneficial owners and to give their own details for the record. In reality, Mr. Ecks and his four fellow shareholders are all part of Mr. Krook's crime organisation and again, the register will be incorrect.

The situation is considerably worse if the directors are themselves corrupt. If the directors were willing to commit an offence by making false statements, they could declare that PropCo has no beneficial owners even if they know that this is not the case.

In all of these examples, criminal offences have been committed by Mr. Ecks, the other shareholders and (in the last case) the directors, but how will Companies House know that this is the case? Without investigation in the Offshore Islands and Onshoreland, there is simply no basis on which to establish this, and in the first two examples, the directors are blameless. Even if the false statements are discovered, will the UK police have sufficient resources to track down Mr. Ecks and his fellow shareholders? And even if they do track them down, will Onshoreland extradite them to the UK to face trial?

Conclusion

Technical consultation may amend the draft bill somewhat, but in its current form, it is a well-intentioned though flawed attempt to introduce more transparency into the UK real estate market. Those people who have used offshore vehicles to acquire UK property for the confidentiality this confers will have to think about whether the loss of that confidentiality is a reason to sell up, or to look to co-investment, so they genuinely do not have a 25% or greater share of the entity that owns the property.

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