

De Jure

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PMLA and Reporting Entity



Who is a Reporting Entity?

Reporting Entity¹ means: -

- banking company,
- financial institution,
- intermediary, or
- person carrying on a designated business or profession.

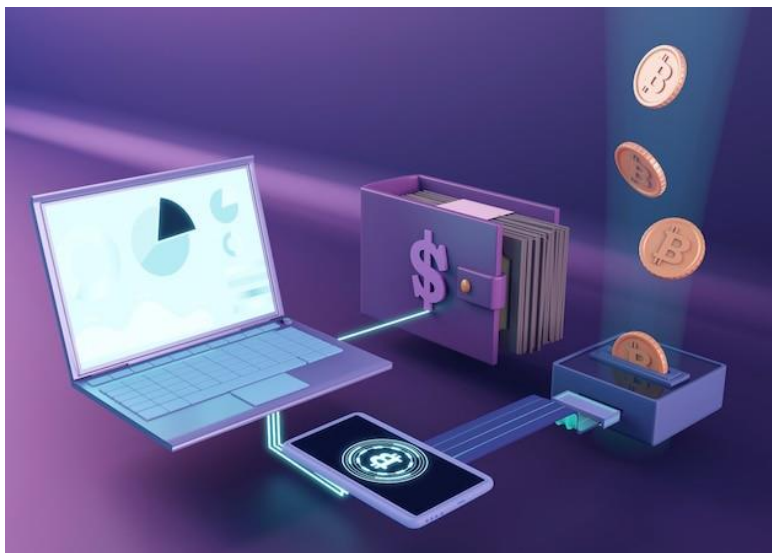
All these terms are defined. Other than "banking company", the three other terms were introduced in 2013. Briefly:

- "Banking company" means a banking company or a co-operative bank, and includes banking institutions;
- "financial institution" means a financial institution and includes a chit fund company, a housing finance institution, an authorised person, a payment system operator, a NBFC and the Department of Posts in the Government of India;
- "intermediary" is a wide term to mean a stock-broker, share transfer agent, banker to an issue, trustee to a trust deed, registrar to an issue, merchant banker, underwriter, portfolio manager, investment adviser or any other intermediary associated with securities market and registered under SEBI, an association recognised or registered under the Forward Contracts (Regulation) Act, 1952 or any member of such association, intermediary registered by the Pension Fund Regulatory and Development Authority; or a recognised stock exchange;
- "person carrying on designated business or profession" is also wide to mean a person carrying on activities for playing games of chance for cash or kind, and includes such activities associated with casino, Inspector-General of Registration,

¹ This term was introduced pursuant to Amendment Act 2 of 2013 (w.e.f. 15 February 2023).

real estate agent, dealer in precious metals, precious stones and other high value goods, person engaged in safekeeping and administration of cash and liquid securities on behalf of other persons, and person carrying on such other activities as may be notified from time to time.

VIRTUAL DIGITAL ASSETS



On March 7, 2023, the Government notified certain activities when carried out for or on behalf of another natural or legal person in the course of business as an activity for the purposes of Section 2(1)(sa)(vi), namely: (i) exchange between virtual digital assets and fiat currencies, (ii) exchange between one or more forms of virtual digital assets, (iii) transfer of virtual digital assets, (iv) safekeeping or administration of virtual digital assets or instruments enabling control over virtual digital assets; and (v) participation in and provision of financial services related to an issuer's offer and sale of a virtual digital asset.

Predominantly, March 2023 Notification revolves around "virtual digital asset" (VDA). In the Note, we will not labour on VDA.

FINANCIAL TRANSACTIONS AND RELEVANT PERSONS

Recently, on May 3, 2023 the Government notified certain "financial transactions" carried out by a "relevant person" (on behalf of his "client") in the course of his or her profession as an activity for the purposes of Section 2(1)(sa)(vi).

A "client" is a person who is engaged in a financial transaction or activity with a Reporting Entity, and includes a person on whose behalf the person who engaged in the transaction or activity, is acting, i.e. beneficial owner. In turn, the term "beneficial owner" is defined to mean an individual who ultimately owns or controls a client of a Reporting Entity or the person on whose behalf a transaction is being conducted and includes a person who exercises ultimate effective control over a juridical person. This can, in turn, take us to who exercises effective "control" over a juridical person. However, we will pause here.



Such "financial transactions" are buying and selling of any immovable property; managing of client money, securities or other assets; management of bank savings or securities accounts; organisation of contributions for the creation operation or management of companies; and creation operation or management of companies LLP or trusts, and buying and selling of business entities.

The "relevant persons" are Chartered Accounts (CAs), Company Secretaries (CS) and Cost and Works Accountants (CWAs).

Simply put, if a CA, in the course of his profession, carries out certain transactions on behalf of his client, e.g. managing client's money, creation of companies or LLP or trusts, then such services will be considered as an "activity" for the Section 2(1)(sa)(vi) of PMLA.

SO, WHAT NEXT? WHAT IS HE (REPORTING ENTITY) REQUIRED TO DO?

We briefly summarise (in simplified text) the obligations of the Reporting Entity. [*It may be prudent to read the exact text of the Act and Notification and/or consult legal advisors.*]

- 1) He must verify the identity of his clients and the beneficial owner (both term discussed above).
- 2) For verification, he must verify the identity by authentication under Aadhar Act² (only if he is a banking company), else do offline verification under the Aadhaar Act, or use of passport or use of any other officially valid document or modes of identification as notified.
- 3) He must maintain a record of all transactions, including information relating to transactions (whether attempted or executed, the nature and value of which may be prescribed), and the manner of maintaining the records must be such that one can reconstruct individual transactions.
- 4) He must furnish to the Director information relating to such transactions (when called upon to do so).
- 5) He must maintain record of documents evidencing identity of its clients and beneficial owners as well as account files and business correspondence relating to its clients.
- 6) He must keep all such information confidential.
- 7) He must maintain the records for five years from the date of transaction.
- 8) The Director can call for from any Reporting Entity any of the records and any additional information as he considers necessary.

² Aadhaar (Targeted Delivery of Financial and Other Subsidies, Benefits and Services) Act, 2016 (18 of 2016)

IT DOES NOT STOP HERE.



Since 2019, there are certain additional obligations in relation to "specified transactions" – defined to mean (a) any withdrawal or deposit in cash, (b) any transaction in foreign exchange, (c) any transaction in any high value imports or remittances; (d) such other transaction or class of transactions, in the interest of revenue or where there is a high risk or money-laundering or terrorist financing, in each case, as may be prescribed.

- 1) ³He must, prior to the commencement of each specified transaction, verify the identity of the clients undertaking such specified transaction by authentication under the Aadhaar Act or by such other process or mode as prescribed.
- 2) He must take additional steps to examine the ownership and financial position, including sources of funds of the client.
- 3) He must take additional steps to record the purpose behind conducting the specified transaction and the intended nature of the relationship between the transaction parties.
- 4) If the client fails to fulfil the aforesaid conditions, then he must not allow the specified transaction to be carried out.
- 5) If he considers any specified transaction (or series of specified transactions undertaken by a client) suspicious or likely to involve proceeds of crime, he must increase the future monitoring of the business relationship with the client, including greater scrutiny.

³ Pursuant to Amendment Act 23 of 2019, w.e.f. August 1, 2019, enhanced due diligence obligations have been imposed on Reporting Entity.

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- 6) He must maintain information obtained while applying the enhanced due diligence measures for a period of 5 years from the date of transaction between a client and the Reporting Entity.

The Act empowers the Director to make inquiry with regard to the obligations of the Reporting Entity, under this Chapter, direct the Reporting Entity to get its records audited by a panelled chartered accountant (at the cost of Central Government). If the Director finds that a Reporting Entity (or its director or any employee) has failed to comply with the obligations, then, the Director may (a) issue a warning, or (b) direct such Reporting Entity (or its director or employee) to comply with specific instructions; or (c) direct such Reporting Entity (or its director or employee) to send periodical reports, or (d) impose a monetary penalty, which shall not be less than Rs.10,000 but not more than Rs.100,000 for each failure.

The Act provides that save as otherwise provided (*discussed above*), the Reporting Entity (its directors and employees) shall not be liable to any civil or criminal proceedings against them for furnishing information.

Simply put, if a Bank, NBFC, Stock Broker, CA, CS (or any other Reporting Entity) is advising a client who will be engaged in certain "financial transactions" or "significant transactions", then he must now do not just basic KYC, but slightly high level verification, maintain records of all transactions, take certain additional steps (such as examine the ownership and financial position, including sources of funds of the client and the purpose behind such specified transaction – which is bit more forensic in nature).

CONTRIBUTED BY:

Prem Rajani, Managing Partner: prem@rajaniassociates.net

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Contact US



Rajani Associates

simple solutions

Address: Krishna Chambers
59 New Marine Lines
Churchgate
Mumbai 400020
Maharashtra, India
Telephone: (+91-22) 40961000
Facsimile: (+91-22) 40961010
Email: dejure@rajaniassociates.net
Website: www.rajaniassociates.net
