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CORPORATE PROFESSIONALS UNDER PMLA'S SCANNER



The recent notifications issued by the Ministry of Finance, Govt. of India (“**MoF**”) in May 2023 have broadened the ambit of ‘reporting entities’¹ under the Prevention of Money Laundering Act, 2002 (“**PMLA**”). Reporting entities now include practising chartered accountants (“**CA**”), company secretaries (“**CS**”), cost and management accountants (“**CMA**”). This has sent corporate professionals into a state of frenzy, as they have now been brought under the iron hand of PMLA. Prior to the notifications, reporting entities included banking companies, financial institutions, intermediaries and people carrying on a designated business or profession². The reporting obligations specified under the PMLA and the Prevention of Money Laundering (Maintenance of Records) Rules, 2005 (“**Rules**”) vis-à-vis reporting entities include verification of the identity of its clients³, maintaining records of transactions for a certain specified period⁴, conducting a thorough due diligence⁵ inter alia.

May 2023 Notifications

Broadening the net of reporting entities under the PMLA, on 3rd May 2023⁶, CAs, CS’ and CMAs, along with the financial transactions carried out by them were brought under the purview of reporting entities. The activities covered by the notification include, inter alia, buying and selling of any immovable property; managing of client money, securities or other assets, bank savings or securities accounts; creation, operation or management of companies, LLPs.

A subsequent notification issued just days after, i.e., on 9th May 2023⁷ further expanded the scope of the activities to be reported, and now includes activities such as:

1. *acting as (or arranging for another person to act as) a director or secretary of a company, a partner of a firm*
2. *or a similar position in relation to other companies and limited liability partnerships;*
3. *providing a registered office, business address or accommodation, correspondence or administrative address*
4. *for a company or a limited liability partnership or a trust;*
5. *as (or arranging for another person to act as) a trustee of an express trust or performing the equivalent*
6. *function for another type of trust; and*
7. *acting as (or arranging for another person to act as) a nominee shareholder for another person.*

(As extracted from the notification)

The notifications have been necessitated due to the rise in ‘loan-related frauds’ in India. Funds are being routed through, professionals who spearhead and complete the compliances in India. However, these professionals are often unaware of the further use of the funds once they are wired out. The notifications will compel the CAs, CS’ and CMAs to increase the level of due diligence being presently conducted and mandatorily report ostensibly dubious transactions also.

Challenge before the Delhi High Court

In August 2023, the notification dated 3rd May 2023 was challenged before the Delhi High Court⁸ by a practising CS on the grounds. Firstly, it was stated that the notification is burdensome on the professionals prescribed therein, as the obligations imposed would require them to closely monitor their clients. This places the professionals in a precarious area where any omission, bona fide or otherwise, would be construed as a violation under PMLA. Secondly, the notification has the potential of compromising the fiduciary bond shared between the clients and the professional, which would also cause clients to not make full disclosures to the professionals. Thirdly, the nature of obligations imposed on reporting entities is unclear insofar as they describe the transactions but omit to specify the monetary threshold of the specified transactions, thereby causing confusion on what the actual responsibilities of the professionals are and how they would categorise the transactions which are to be reported from those which aren't.

The High Court of Delhi, noting the lack of clarity on the specified thresholds of reporting, has sought a clarification from the Centre on the concept of specified transactions within the PMLA which need to be reported.

Critical Analysis of the Notifications

At first blush, the notifications seem to be straightforward and concise. However, a deeper dive into their practical application and what the notifications entail for the corporate professionals mentioned therein brings to the fore certain issues.

Shifting the Burden on Corporate Professionals

A plain reading of the notifications makes it amply clear that the government has now shifted the burden of reporting 'questionable and suspicious' transactions on the professionals handling them. These notifications are premised on the logical inference that where large amounts of money are being laundered, there is a high possibility that one of the specified professionals in the notifications is managing them. Thus, the obligation has now been placed on corporate professionals to detect and monitor transactions and be liable for the penal consequences in the event of a violation. Thus, the expectation from the corporate professionals would now be to act as the 'eyes and ears' of the Centre⁹.

Increased Obligation for Compliance

Under the May 2023 notifications, the nature of financial activities which have been prescribed form the very crux of the business functions carried out by these professionals. By including CAs, CS' and CMAs under its scope, the compliance obligation on these professionals has significantly increased as they will now be required to carry out detailed KYCs and perhaps even face-to-face meetings with clients to for verification of their identity, as prescribed under the PMLA. In addition to being cumbersome, this will also cause delays in the documentation and substantially increase costs, which will have to be borne by the professionals only. The notifications also impact small-scale professionals, who at times act as a liaison between larger entities. Now, the small-scale professionals will have to adhere to stringent reporting norms as well.

Imprecise Notification

Further, the practical implications of the notifications raises pertinent questions, such as how the detailed reporting of clients would have to be conducted, and which transactions would fall within the ambit of 'specified transactions', as the same would be subjective. The multifarious scenarios which require clarifications include situations where assignments are taken on a referral basis from other professionals or business houses, or where several assignments are taken under a group, where the entities are based out of India and so on. Furthermore, the notifications also would, to some extent, reveal the internal practices, (put in place as quality checks) of the professionals, thus forcing them to disclose practices which give them an edge in the profession.

Selective Inclusion – the Issue Regarding 'Privileged Communications'

In addition to being considered tedious, the notifications have also failed to include 'lawyers' within their scope. The MoF has also overlooked the fact that several lawyers and their offices also carry out at least some of the activities enumerated in the notifications. Furthermore, CAs, CS', CMAs often work closely with lawyers and advise their clients on the activities covered by the notifications. Communications between an advocate and his/her client are privileged, and any communication made to him/her during the course of their employment is required to be kept confidential¹⁰. This also includes advisory communication within its scope¹¹. While these professionals alone don't have privilege, judicial pronouncements over the years have expounded the scope of the privilege to now include advisory communications. It also extends to documents exchanged between accounting professionals and lawyers in service of their client¹².

Strained Relationship between the Professionals and their Clients

The role of CAs, CS' and accounting professionals has been enlarged over the years to include matters of corporate governance and commercial advisory as well. A key aspect of the duties carried out by corporate professionals is 'confidentiality' and 'non-disclosure' of client information to third-parties and has also been, at times, termed as a fiduciary relationship¹³. A 'fiduciary relationship' has been defined by the Supreme Court of India to refer to a person who has the duty to act for the benefit of another person, in good faith and honesty. The person places absolute faith and confidence regarding his/her business operations and transactions in the person who discharges the fiduciary duty¹⁴.

The Chartered Accountants Act, 1949, also emphasizes on the non-disclosure of information acquired during his/her professional engagement to any person other than the client so engaging him/her. There can be no disclosure without the consent of the client¹⁵. The role of a CS as a 'watchdog' for the company, to act in the best interest of the company and its stakeholders, especially in the failure of a Director¹⁶ to do so has also been recognised by the company law tribunals of the country¹⁷.

While the fiduciary duty of corporate professionals is not mentioned explicitly in any statute, certain courts have taken the view that CAs, CS' have a fiduciary duty towards their clients. Thus, the mandatory reporting under the PMLA could be seen as being in the contrary to the nature of relationship which corporate professionals have with their clients, which is based on trust and confidentiality¹⁸.

Footnotes:

¹ Section 2(1) (wa), Prevention of Money Laundering Act, 2002 (PMLA).

² Section 2(1) (sa), *ibid.*

³ Section 2(1) (ha), *ibid.*

⁴ Section 12, *ibid.*

⁵ Section 12AA, *ibid.*

⁶ Notification, Department of Revenue, Ministry of Finance, Govt. of India (3 May 2023), available at <<https://egazette.gov.in/WriteReadData/2023/245631.pdf>> accessed on 27 Aug. 23.

⁷ Notification, Department of Revenue, Ministry of Finance, Govt. of India (9 May 2023), available at <<https://egazette.gov.in/WriteReadData/2023/245764.pdf>> accessed on 27 Aug. 23.

⁸ *Rajat Mohan Vs. Union of India & Ors.*, W.P. (C) 11054 of 2023, Delhi High Court.

⁹ Centre's stand sought on plea against inclusion of CAs under money laundering law, *Economic Times* (21 Aug. 2023) <https://economictimes.indiatimes.com/news/india/centres-stand-sought-on-plea-against-inclusion-of-cas-under-money-laundering-law/articleshow/102900498.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst> accessed on 31 Aug. 23.

¹⁰ Section 126, Indian Evidence Act, 1872.

¹¹ *Larsen & Toubro Ltd Vs. Prime Displays (P) Ltd.*, (2002) 5 Bom CR 158.

¹² *Vishnu Yeshawant Wagh Vs. New York Life Insurance Co.*, (1905) 7 Bom LR 709.

¹³ *Council of Institute of Chartered Accountant of India Vs. Om Prakash Tulsyan*, MANU/UP/3473/2016.

¹⁴ *Bihar Public Service Commn Vs. Saiyed Hussain Abbas Rizwi & Anr.* (2012) 13 SCC 61.

¹⁵ Clause 1, Part – I, Second Schedule read with Sections 21(3), 21B(3) and 22, The Chartered Accountants Act, 1949.

¹⁶ Section 166: Duties of Directors, Companies Act, 2013:

....

(2) A director of a company shall act in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interests of the company, its employees, the shareholders, the community and for the protection of environment.

(3) A director of a company shall exercise his duties with due and reasonable care, skill and diligence and shall exercise independent judgment.

(4) A director of a company shall not involve in a situation in which he may have a direct or indirect interest that conflicts, or possibly may conflict, with the interest of the company.

¹⁷ *M/s. Technology Frontiers (India) Private Limited Vs. Global Sports Commerce Pte Ltd & Ors.*, CP / 75 / CHE / 2021 (July 2022) NCLT Chennai.

¹⁸ Guidance Note on Code of Conduct for Company Secretaries, Institute of Company Secretaries of India (2014) <https://www.icsi.edu/media/webmodules/publications/Guidance_Note_CodeofConduct_CompanySecretaries.pdf> accessed on 31 Aug. 23.

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