



India: Dematerialisation Of Securities For Unlisted Companies – Recent Changes In Indian Law

Last Updated: 26 August 2019

Article by [Sameer Sah](#)

Khaitan & Co



Your [LinkedIn](#)
Connections at Firm



Most Read Contributor in India, July 2019



Introduction

Under Indian law, shares of an unlisted company could hitherto either be held in physical form (i.e., represented by letters of allotment / share certificates issued against such shares) or in dematerialised form (i.e., by opening an account with a depository participant, "Demat Account"). Both approaches had their own pros and cons. Holding shares in physical form afforded some flexibility in terms of not having to maintain a Demat Account, which, apart from any costs associated with it, also involved some administrative maintenance such as keeping track of who the signatory of the Demat Account was, and other similar considerations. At the same time, holding shares in dematerialised form afforded the opportunity to indulge in some stamp duty savings on transfer as transfer of shares held in physical form required the execution of a share transfer form which attracts a stamp duty of 0.25%. Note that the stamp duty benefit of the transfer of shares in dematerialised form may also be short-lived, given the changes proposed to be introduced by the Finance Act, 2019 that are yet to be made effective.

In September 2018¹, however, the Ministry of Corporate Affairs amended the Companies (Prospectus and Allotment of Securities) Rules, 2014 (the "PAS Rules") to significantly revise these requirements. Subsequently, in January 2019² and May 2019³ the relevant provisions of the PAS Rules were further amended. This article summarises the position as of now and how this impacts certain planning activities pertaining to holding shares of Indian companies.

Summary of the current position⁴

Effective from 2 October 2018:

1. Each public company must issue "securities" only in dematerialised form, going forward, and should facilitate the dematerialisation of all its "securities"⁵.
2. A public company can initiate an offer of "securities" (including, by way of bonus, rights, etc.) only after ensuring that securities held by promoters, directors and KMP are dematerialised⁶ and provided that there are no outstanding fees payable to necessary functionaries involved in this process (share transfer agent, registrar to issue, depository)⁷.
3. A person intending to subscribe to "securities" of a public company must ensure his existing shareholding in the company is in dematerialised form⁸.
4. All requirements of regulations framed in relation to depositories – which were typically applicable to listed companies and their securities – will now apply to unlisted public companies as well.⁹
5. Each public company must engage with necessary functionaries involved in this process (share transfer agent, registrar to issue, depository)¹⁰, for activities such as *inter alia* payment of fees, maintenance of security deposit, following instructions, etc.
6. The Investor Education and Protection Fund Authority shall have authority over grievances of securities holders and shall be able to pass necessary orders against functionaries in consultation with the Securities and Exchange Board of India.¹¹
7. It is however clarified that these stipulations would not apply to a Government company, a Nidhi company or a company that is a "wholly owned subsidiary".¹²

In addition to the above points, there is also a stipulation that a shareholder cannot transfer shares in a public company unless such shares are held in dematerialised form¹³. This has proved to be a rather controversial change, and even from a theoretical perspective – there has been a potential challenge mounted to these stipulations that they are contained in the rules governing issuance of shares and not transfer of shares. Be that articulation as it may, it would arguably be difficult for a well-meaning purchaser to take a view that this stipulation can

be ignored altogether.

Implications and points to consider

Opening a Demat Account requires the applicant to necessarily register with Indian tax authorities and obtain a "Permanent Account Number". Particularly for foreign investors who may only be looking to hold shares with Indian companies and not undertake very many other activities – this might not be a very attractive proposition. This may be evermore true where overseas investors consider having individual employees hold shares in companies to meet the minimum shareholding requirement. Therefore, it might be relevant for overseas investors seeking to invest in Indian public companies to plan their holding patterns appropriately. In acquisition transactions being run as bid processes – this is likely to make first time investors who have hitherto not invested in India more unattractive as opening a Demat Account can be slightly time-consuming – particularly if the shareholder for whom the Demat Account is to be opened is resident / domiciled in a non-English speaking jurisdiction as translation and legalisation of KYC documents can be a time consuming and cumbersome affair.

Conclusion

Traditionally, public companies are not preferred as a corporate business vehicle due to the enhanced number of compliances they attract. These changes increase the administrative burden of incorporating and using public companies even further. Particularly for foreign shareholders, at least in the short term – public companies are likely to become even more unattractive.

Footnotes

1. Companies (Prospectus and Allotment of Securities) Third Amendment Rules, 2018 dated 10 September 2018
2. Companies (Prospectus and Allotment of Securities) Amendment Rules, 2019 dated 22 January 2019
3. Companies (Prospectus and Allotment of Securities) Third Amendment Rules, 2019 dated 22 May 2019
4. As of 26 May 2019
5. Rules 9A(1) and 9A(4) of the PAS Rules
6. Rule 9A(2) of the PAS Rules
7. Rule 9A(6) of the PAS Rules
8. Rule 9A(3)(b) of the PAS Rules
9. Rules 9A(7) and 9A(8) of the PAS Rules
10. Rules 9A(5) of the PAS Rules
11. Rules 9A(9) and 9A(10) of the PAS Rules
12. Rules 9A(11) of the PAS Rules
13. Rule 9A(3)(a) of the PAS Rules
14. Rule 9A(3)(a) of the PAS Rules

The content of this document do not necessarily reflect the views/position of Khaitan & Co but remain solely those of the author(s). For any further queries or follow up please contact Khaitan & Co at legalalerts@khaitanco.com

Do you have a Question or Comment?
Click here to email the Author

Interested in the next Webinar on this Topic?
Click here to register your Interest

Contributor Sameer Sah

Email Firm



More from this Firm



Khaitan & Co

View Website



More from this Author



News About this Firm



Authors

Sameer Sah



Khaitan & Co: 600 employees in your network Following

 Nandini K. (2nd) Partner at Khaitan & Co.	 Shourya Sengupta (2nd) Senior Associate at Khaitan & Co
 Aditya George Cheriyan (2nd) Partner, Capital Markets at Khaitan & Co	 Adheesh Nargolkar (2nd) Partner at Khaitan & Co.

In Your Network powered by

[Contact Us](#) | [Your Privacy](#) | [Feedback](#)


© Mondaq® Ltd 1994 - 2019
All Rights Reserved