

Whether Companies Amendment Act, 2019 contemplates dematerialization of shares for private companies?

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Rule 9 of the Companies (Prospectus and Allotment of Securities) Rules, 2014 ('PAS Rules') relates to 'Dematerialisation of securities'. According to Rule 9 of the PAS Rules, the promoters of every public company making public offer of any convertible securities may hold such securities only in dematerialised form. Rule 9 further states that the entire holding of convertible securities of company by the promoters held in physical form up to the date of the initial public offer shall be converted into dematerialised form before such offer is made and thereafter such promoter shareholding shall be held in dematerialized form only.

Provisions for mandatory de-mat of securities: The PAS Rules were amended¹ for the issue of securities in dematerialised form by unlisted public companies. According to the PAS Rules, Depositories Act, 1996 and Regulations made thereunder, every unlisted public company shall:

- (i) Issue the securities only in dematerialised form; and
- (ii) Facilitate dematerialisation of all its existing securities (i.e. conversion of physical share certificates into electronic shares).

Restrictions on Unlisted Public Company: According to the amended Rules, every holder of securities of an unlisted public company:

- (i) Who intends to transfer such securities shall get such securities dematerialised before the transfer; or
- (ii) Who subscribes to any securities of an unlisted public company (whether by way of private placement or bonus shares or rights offer) shall ensure that all his existing securities are held in dematerialized form before such subscription.

Cost of dematerialization of securities: After the amendment, every unlisted public company shall follow the mandatory compliances w.r.t.:

- (i) Timely payment of admission fees and annual fees to the Depository (NSDL or CDSL) and Registrar to an issue and share transfer agent,
- (ii) Maintenance of security deposit at all times, of not less than 2 years, fees with Depository and Registrar to an issue and share transfer agent, and

(iii) Compliance with Regulations / Directions issued by SEBI or NSDL / CDSL from time to time.

If such unlisted public company makes the above-mentioned default in payment, then it shall not make an offer of any securities or buyback its securities or issue any bonus or right shares till such payment is made.

Regular Compliance for de-materialization: Every unlisted public company shall obtain a certificate from practising CS / CA and submit with Registrar of Companies within 60 days from the conclusion of each half year.

Compulsory De-mat provision under the Act: Section 29 of the Act relates to 'Public Offer of Securities to be in Dematerialised Form'. According to the extant provisions of the Act, every company making public offer, and such other class or classes of public companies as may be prescribed, shall issue the securities only in dematerialised form by complying with the provisions of the Depositories Act, 1996 and the regulations made thereunder.

Amendments proposed in the Companies (Amendment) Act, 2019: According to the Companies (Amendment) Act, 2019, the reference of 'public' in 'public offer' has been omitted. Therefore, after the amendment, every company making offer of securities (i.e. offer of securities on rights basis or private placement basis or preferential offer basis) and such class or classes of prescribed companies shall issue securities in dematerialized form. According to the Amendment Act, the securities of class or classes of unlisted companies (as may be prescribed) shall be held or transferred only in dematerialised form in accordance with the Depositories Act and Regulations made thereunder.

The issue for interpretation is whether Ministry of Corporate Affairs will mandate de-mat of securities for private companies? Or whether such amendment is to provide necessary reference in the Act for the Rule 9A introduced in PAS Rules, 2014.

According to Clause 7 of the Notes on clauses of Companies (Amendment) Bill, 2019², section 29 of the Act is amended to provide for the requirement of issuance, holding or transferring of securities in dematerialised form for any class of unlisted companies, as may be prescribed by the Central Government. The Notes on Clauses of the Companies (Amendment) Bill, 2019 gives some indication that the provisions would apply to unlisted public companies.

According to the Statement of Objects and Reasons to the Companies (Amendment) Bill, 2019³, the Bill proposes to replace the Companies (Amendment) Second Ordinance, 2019 with certain other amendments which are considered necessary to ensure more accountability and better enforcement to strengthen the corporate governance norms and compliance management in corporate sector.

Dematerialization of shares of private companies would not in any ways promote ease the doing business, however, it would add an annual cost of Depositories, Registrar and Share Transfer Agents, Compliance Certificate by practicing professional, filing the certificate with the Registrar of Companies. Also, in quite a few private companies, the transfer of shares is not a routine activity. According the provisions of Section 2(68) of the Act read with the Articles of Association of such private companies, there is a restriction on transfer of shares i.e. shares are not freely transferable. Considering this essential feature of private company, it is desirable that the Government doesn't direct dematerialization of shares of private companies under the garb of 'transparency', 'accountability', 'better enforcement to strengthen the corporate governance norms' and 'compliance management in corporate sector'.

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- [1.](#) Inserted by the Companies (Prospectus and Allotment of Securities) Third Amendment Rules, 2018 dated September 10, 2018.
 - [2.](#) Companies (Amendment) Bill, 2019 as introduced in Lok Sabha.
 - [3.](#) Companies (Amendment) Bill, 2019 as introduced in Lok Sabha.