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Practical issues in demat of securities of not small companies



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With objective to enhance transparency in shareholding of Indian companies and ease in maintaining statutory records, the Ministry of Corporate Affairs extended the compulsory demat of securities to private companies which are not small companies. It is important to note that said amendment is applicable to 'securities' and not just 'shares'.

Background: Section [29](#) of the Companies Act relates to 'Public offer of securities to be in dematerialised form'. According to the said provisions, every company making public offer (i.e. only a public company) and such other class or classes of 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. Earlier 'such other class or classes of companies' meant only 'public companies', however, by the Companies (Amendment) Act, 2019 and with effect from August 15, 2019, the word public was omitted, by which the Government was empowered to prescribe the class of companies (private and public companies, both) for issuing securities only in dematerialised form. The Companies (Amendment) Act, 2019 also provided that in case of such class or classes of unlisted companies as may be prescribed (i.e. public and private companies, both), the securities shall be held or transferred only in dematerialised form in the manner laid down in the Depositories Act, 1996 and the regulations made thereunder. Sub-section (2) of section 29 of the Companies Act, gives an option to any company (not statutorily mandated under the said provisions) to convert its securities into dematerialised form or issue its securities in physical form in accordance with the provisions of Companies Act read with the Depositories Act, 1996 and the regulations made thereunder. Rule [9A](#) and [9B](#) of the Companies (Prospectus and Allotment of Securities) Rules, 2014 have been introduced based on the provisions of section 29 of the Companies Act.

Introduction - issue of securities in dematerialised form by unlisted public companies: Rule 9A of the Companies (Prospectus and Allotment of Securities) Rules, 2014 was introduced in the said Rules with effect from October 2, 2018. According to the said Rules every unlisted public company shall: (a) Issue the securities only in dematerialised form; and (b) Facilitate dematerialisation of all its existing securities, in accordance with provisions of the Depositories Act, 1996 and regulations made thereunder.

The timelines for compliance were clearly mentioned in the Rules. In fact, there was no concern about the applicability of the said Rules (as compared to not 'small companies' as on March 31, 2023).

According to Rule 9A of the Companies (Prospectus and Allotment of Securities) Rules, 2014, every holder of securities of an unlisted public company: (a) who intends to transfer such securities on or after October 2, 2018, shall get such securities dematerialised before the transfer; or (b) who subscribes to any securities of an unlisted public company (whether by way of private placement or bonus shares or rights offer) on or after October 2, 2018 shall ensure that all his existing securities are held in dematerialized form before such subscription.

Introduction – Issue of securities in dematerialised form by private companies:

The Ministry of Corporate Affairs introduced the Companies (Prospectus and Allotment of Securities) Second Amendment Rules, 2023¹ on October 27, 2023, whereby several provisions in the Rules were introduced.

According to the provisions of the Companies Act and the Rules, the companies which are not 'small companies' are private companies whose paid-up share capital exceeds Rs. 4 crores and turnover exceeds Rs. 40 crores respectively (both conditions to be satisfied). Such companies also include private companies which are holding companies, subsidiary companies, companies registered under section [8](#) of the Companies Act, a company or body corporate governed by any special Act.

In this article, there is discussion on few unaddressed practical issues in dematerialising securities by such private companies which are not small companies.

(1) Applicability: According to Rule 9B(2) of the Companies (Prospectus and Allotment of Securities) Rules, 2014, a private company, which as on last day of a financial year, ending on or after March 31, 2023, is not a 'small company' as per audited financial statements for such financial year, shall, within 18 months of closure of such financial year, comply with the said provisions. Some of the practical issues in the compliances are as follows:

- (a) A private company has exceeded the monetary thresholds on March 31, 2023 and then in the next financial year ended March 31, 2024, the company is a 'small company' due to the change in share-capital or decrease in the turnover of the company. Question is – whether such company is required to comply with the said provisions by September 30, 2024 (the date on which the company is a 'small company')? Based on the extant provisions, the compliance is required.
- (b) A private company is a holding company of another company/companies on March 31, 2023 and then in the next financial year ended March 31, 2024, due to corporate restructuring activities, such private company holds 20% of the capital of other company/companies i.e. it is no longer a holding company by March 31, 2024. The company is a 'small company' due to the change in share-capital or decrease in the turnover of the company. Question is – whether such company is required to comply with the said provisions by September 30, 2024 (the date on which the company is a 'small company')? Based on the extant provisions, the compliance is required.
- (c) A private company incorporates a subsidiary company outside India and complies with all relevant applicable foreign exchange laws in India. Under the Companies Act, there is no immediate reporting required except consolidation of annual financial statements and related activities. Question is – how the cut-off period and dates are to be calculated for the compliance of the said provisions?

- (d) A company incorporated under section 8 of the Companies Act is not a 'small company' and hence the provisions of the said Rules are applicable, irrespective of the share capital and turnover. Such applicability and related annual compliances will amount to high cost of compliance of section 8 companies. Considering the transparency for section 8 companies (since incorporation) and a preferred entity structure for Corporate Social Responsibility (CSR) activities, the applicability of the said Rules will be an impediment for companies incorporated under section 8 of the Companies Act.
- (e) The said Rules provide for the applicability for a private company (which is not a 'small company') as on last day of a financial year, ending on or after **March 31, 2023**. The said Rules have not provided for companies with financial year other March 31. In fact, many foreign subsidiaries in India will be required to comply with the said Rules and many such companies have aligned their financial year with its parent company under section [2\(41\)](#) of the Companies Act. Therefore, the applicability ought to have been last date of the financial year (as opted by the company and necessary approvals obtained) and not 31st March.

- (2) Issue, buy-back, bonus of securities:** According to Rule 9B(3) of the Companies (Prospectus and Allotment of Securities) Rules, 2014, every private company (as referred to in Rule 9B(2) of the said Rules) making any offer for issue of any securities or buyback of securities or issue of bonus shares or rights offer, after the date when it is required to comply with this rule, shall ensure that before making such offer, entire holding of securities of its promoters, directors, key managerial personnel (KMP) has been dematerialised in accordance with the provisions of the Depositories Act, 1996 and regulations made thereunder. Practical issue – if a company proposes any corporate action as mentioned in the said Rules during the period October 27, 2023 till September 30, 2024, question is – whether such companies are required to entirely complete the compliance under the said Rules? Taking into consideration the language and wordings of the said Rules, in my view, such compliance is not required to be done immediately from the date of the notification. The MCA has given time for the applicable companies to comply with the said Rules.
- (3) Transfer of securities:** According to Rule 9B(4) of the Companies (Prospectus and Allotment of Securities) Rules, 2014, every holder of securities of the private company (applicability – as discussed above) who intends to transfer such securities on or after the date when the company is required to comply with this rule, shall get such securities dematerialised before the transfer. Similar practical issue – such transfer of securities is proposed during the period October 27, 2023 till September 30, 2024, question is – whether such transfer of securities is required in demat form? Taking into consideration the language and wordings of the said Rules, in my view, such compliance is not required to be done immediately from the date of the notification. The MCA has given time for the companies to comply with the said Rules.
- (4) What is facilitation of dematerialisation of all its securities?** This question was relevant and important even for unlisted public companies when the amendments were introduced in October 2018. In my view, the pre-requisites for 'facilitation of dematerialisation' of securities is provided in the amended Rules. Based on Rule 9A and 9B of the Companies (Prospectus and Allotment of Securities) Rules, 2014, the 'facilitation of dematerialisation' would include the activities of making an application to Depository, securing International Security Identification Number (ISIN) for each type of security and informing all its existing security holders about the demat facility.
- (5) Whether Articles of Association of the company be amended for dematerialisation of securities?** Since share and securities of private companies are transferable in accordance with the provisions of the Articles of Association of the company, in my view, the Articles of Association

of the company shall be amended before making an application for dematerialisation of securities.

- (6) **Exemptions under Rule 9B of the Companies (Prospectus and Allotment of Securities) Rules, 2014:** Under the extant provisions of the said Rules, only Government Companies are exempt from the compliance of the said Rules. However, Rule 9A of the Companies (Prospectus and Allotment of Securities) Rules, 2014 was not applicable to Nidhi Company, Government Company, wholly owned subsidiary company. As per extant provisions, a private company which is a wholly owned subsidiary company (in compliance with the provisions of the Companies Act) is not exempted from the compliance of Rule 9B of the Companies (Prospectus and Allotment of Securities) Rules, 2014. MCA should consider similar exemption under Rule 9B of the Companies (Prospectus and Allotment of Securities) Rules, 2014 for private companies which are wholly owned subsidiary companies.
- (7) **Joint shareholding v. Nominee shareholder:** Presently, as per the procedures for opening of demat account, there is no significant difference in opening of demat account for joint shareholders and nominee shareholders. In any case, both the shareholders have to submit the same details, information and documents with the depository participants for opening of the demat account. However, the compliance and applicability of the provisions under the Companies Act are different for companies with joint shareholding and nominee shareholder.
- (8) **Addressing grievances of security holders of private companies:** According to Rule 9B of the Companies (Prospectus and Allotment of Securities) Rules, 2014, sub-rules (4) to (10) of Rule 9A of the Companies (Prospectus and Allotment of Securities) Rules, 2014 shall be applicable to private companies. The grievances, if any, of security holders of unlisted public companies under Rule 9A shall be filed before the Investor Education and Protection Fund Authority. Now, this Rule is applicable to private companies which are not 'small companies'. Therefore, securities holders of private companies are empowered to file their grievances before the Investor Education and Protection Fund Authority. Considering that private companies (whether 'small company' or not) are closely held, there shall be an internal mechanism for redressing grievances of security holders of private companies.
- (9) **Half yearly compliance - submission of Form PAS - 6 with MCA:** All the private companies (which are not 'small companies') shall submit e-Form PAS - 6 to the Registrar of Companies within 60 days from the conclusion of each half year duly certified by a CS in practice or CA in practice. The cost of this half-yearly compliance would largely affect companies incorporated under section 8, wholly owned subsidiary companies, subsidiary companies whose share capital has not changed since incorporation as they have adequate revenues from India operations, etc. In my view, this compliance ought to have been an annual compliance for all such private companies.

Taking into consideration the above-mentioned practical issues and with an object to ease of doing business and ease of compliance, the said Rules needs to be amended w.r.t. its applicability, timelines for compliance, reporting requirements and the cost of compliance.

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1. MCA Notification G.S.R. 802(E) [F. No. 1/21/2013-CL-V], dated 27-10-2023.