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[2025] 170 taxmann.com 368 (Article)[©]Date of Publishing: **January 15, 2025****Private Company which is wholly-owned subsidiary of Public Company –
Whether the provisions of compulsory Demat are applicable?****GAURAV PINGLE**

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Introduction: The provisions relating to compulsory demat of securities for not Small Companies was introduced by the Ministry of Corporate Affairs by Notification dated October 27, 2023¹. By the said notification, Companies (Prospectus and Allotment of Securities) Rules, 2014 were amended and Rule 9B was introduced. The said Rule relates to 'Issue of securities in dematerialised form by private companies'.

According to the amendment, private companies which are not Small Companies (as on March 31, 2023 or after) are required to issue the securities only in dematerialised form and facilitate dematerialisation of all its securities. The facilitation of dematerialisation of all its securities requires company to make necessary application to a Depository (NSDL/CDSL) and secure International Security Identification Number ('ISIN') for each type of security. The company shall inform all its existing security holders about such facility.

In relation the compulsory demat of securities, there is an interesting question – whether the said provisions are applicable to:

1. Private company which a subsidiary company of public company,
2. Private company which a wholly-owned subsidiary (WOS) of public company.

Applicability of the provisions and definition of 'Small Company' with exceptions: According to section 2(85) of the Companies Act, 2013 and Rule 2(1)(t) of Companies (Specification of definitions details) Rules, 2014, a small company means a private company whose paid-up capital and turnover does not exceed Rs. 4 crores and Rs. 40 crores, respectively. According to the said provisions, following companies are not 'Small Company', therefore compulsory demat is applicable from the date of the notification:

1. Holding company,
2. Subsidiary company,
3. Company registered under section 8 of the Companies Act,
4. Company or body corporate governed by any special Act.

A holding company (which is a 'private company' in accordance with section 2(68) of the Companies Act) can have a subsidiary company which can be either a private company or a public company. Few possibilities are elaborated as under:

- (a) *Holding company is a private company and subsidiary company is also a private company:* For both the

companies, the provisions of compulsory demat will apply i.e. Rule 9B of Companies (Prospectus and Allotment of Securities) Rules, 2014 (both are not Small Companies as they are holding-subsidary companies);

- (b) *Holding company is a private company and subsidiary company is a public company*: In this case, the said private company is not a small company under section 2(85) of the Companies Act, hence the provisions of compulsory demat will apply. The subsidiary company is a public company and compulsory demat provisions will apply under Rule 9A of Companies (Prospectus and Allotment of Securities) Rules, 2014.

The question arises when a private company is a subsidiary company of a public company. For such subsidiary company – Whether the provisions of compulsory demat are applicable under Rule 9A of Companies (Prospectus and Allotment of Securities) Rules, 2014 ('Rule 9A') or Rule 9B of Companies (Prospectus and Allotment of Securities) Rules, 2014 ('Rule 9B')?

Rule 9A is applicable to public companies, with an exception to Nidhi company, Government company and wholly-owned subsidiary company (i.e. a public company)².

Rule 9B is applicable to Private Companies which are not small companies. Only exception is Government company³.

Status of a Private Company subsidiary of a Public Company: According to section 2(68) of the Companies Act, 2013, 'private company' means as a company which by its Articles of Association: (i) Restricts the right to transfer its shares, (ii) Limits the number of its members to 200, (iii) Prohibits any invitation to the public to subscribe for any securities of the company.

Section 2(71) of the Companies Act, 2013 defines 'public company' as a company which is not a private company and has a minimum paid-up share capital as may be prescribed⁴.

With respect to the status of a private company which is a subsidiary of a public company, the proviso to section 2(71) of the Companies Act, 2013 provides that – "*Provided that a company which is a subsidiary of a company, not being a private company, shall be deemed to be public company for the purposes of this Act even where such subsidiary company continues to be a private company in its articles*". Therefore, such private company shall continue to be a private company in its articles of association, as mentioned above, however, such private company shall be deemed to be a public company for the purposes of the Companies Act. That means such private company shall comply with all the provisions as applicable to public company and at the same time if there are any exemptions or exceptions available to the public company, then the same can be availed by such company.

In *Hillcrest Realty Sdn. Bhd. v. Hotel Queen Road (P.) Ltd.* [2006] 71 SCL 41 (CLB), the Company Law Board (Principal Bench, New Delhi) observed that "*The basic characteristics of a private company in terms of section 3(iii) of the Act⁵ do not get altered just because it is a subsidiary of a public company in view of the fiction in terms of section 3(3)(iv) (c) of the Act⁶ that it is a public company. May be it is a public company in relation to other provisions of the Act but not with reference to its basic characteristics. In terms of that section, a company is a private company when its articles restrict the right of transfer of shares, restrict its membership to 50 (other than employee shareholders) and prohibits invitation to public to subscribe to its shares. Therefore, all the provisions in the articles to maintain the basic characteristics of a private company in terms of section 3(1)(iii)⁷ will continue to govern the affairs of the company even though it is a subsidiary of a public company. One of the basic characteristics of a private company in terms of that section is restriction on the right to transfer and the same will apply even if a private company is a subsidiary of a public company.*".

Applicability of demat provisions to Private Company subsidiary of a Public Company: If a private company is a subsidiary of a public company, then the provisions of Rule 9A will be applicable, as such company is deemed to be a public company (i.e. pursuant to the proviso to section 2(71) of the Companies Act).

However, if a private company is a wholly-owned subsidiary company of a public company, then neither the provisions of Rule 9A nor Rule 9B will apply to such private company. Rule 9B will not apply as the said provisions are

applicable to only private companies, whereas the Wholly-Owned Subsidiary company is a 'public company' for the purposes of the Companies Act.

Rule 9A will not apply as the said rule does not apply to Wholly-Owned Subsidiary companies and 'Private Company' which is Wholly-Owned Subsidiary company of public company may take the exemption under Rule 9A.

However, a private company which is Wholly-Owned Subsidiary company of another private company does not have any exemptions and hence both the companies (holding company and subsidiary company) will have to comply with the provisions of compulsory demat of securities.

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

2. Rule 9A(1) read with Rule 9A(11) of Companies (Prospectus and Allotment of Securities) Rules, 2014.

3. Rule 9B(1) read with Rule 9B(6) of Companies (Prospectus and Allotment of Securities) Rules, 2014.

4. According to Companies (Amendment) Act, 2015, the minimum paid-up share capital criteria is removed.

5. i.e. Companies Act, 1956.

6. i.e. Companies Act, 1956.

7. Of Companies Act, 1956.