

# COMPULSORY DEMATERIALISATION OF THE SHARES

March 7, 2024

## Issue of securities in demat form by private companies

The Ministry of Corporate Affairs (MCA) has notified the Companies (Prospectus and Allotment of Securities) (Second Amendment) Rules, 2023 (Amended PAS Rules).

The major changes are:

- (a) *public companies must convert share warrants (issued before the Companies Act, 2013) into dematerialised shares.*
- (b) *private companies (except small companies) must convert all existing securities into dematerialised form.*

The term “securities” in the Amended PAS Rules covers various instruments like equity shares, preference shares, debentures, and warrants, as defined by the Securities Contracts (Regulation) Act, 1956 (SCRA).

### Meaning of Dematerialisation

Dematerialisation means the conversion of physical securities into an electronic format.

### Purpose of Dematerialisation

- Increase transparency in shareholding and securities transactions.
- Investors will now be required to furnish ultimate beneficial ownership and senior management details when opening a demat account.
- This will help the regulator develop a centralised database for the country.
- This database will simplify the process of determining beneficial ownership and enhance tax collection efficiency.
- Improved collateral acceptance for securities.
- Reduced disputes and risks associated with physical certificates.
- Decreased risk of loss, theft, and tampering.
- Deterred fraudulent activities like benami transactions, money laundering, and back-dating.

## Implication of Non-Compliance

- The Company will not be able to issue/allot any type of securities.
- The Security holder will not be able to transfer or subscribe to any type of security

## Penalties for Non-compliance

- **On the Company:** INR 10,000 + INR 1,000/ day. The maximum limit is INR 200,000.
- **On every Officer of the Company who is in default:** INR 10,000 + INR 1,000/ day. The maximum limit is INR 50,000.

## ACTIONS TO BE TAKEN

This amendment has brought in two-fold obligations i.e., for private companies and its Security holders.

## DEMATERIALISATION PROCESS

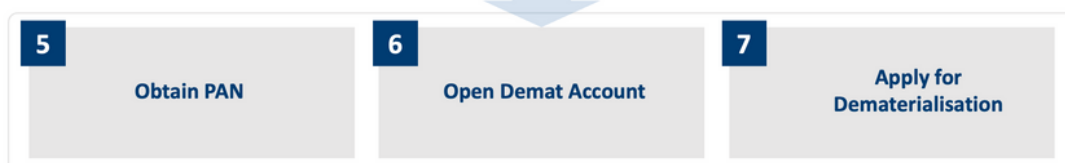
### COMPANIES

Setting-up Demat facility.



### SHAREHOLDERS

Obtain PAN and open Demat account



### 3<sup>RD</sup> PARTIES

Dematerialization of Securities.



## OPERATIONAL CONSIDERATIONS

### Impact on Japanese Subsidiaries in India

Since subsidiaries of foreign entities don't qualify as small companies, they must dematerialise their shares, even if they are small by sales turnover or capital. These subsidiary companies must obtain an International Securities Identification Number (ISIN) from the Depository, for the issued securities, and holding companies in Japan must open demat accounts with SEBI-registered Depository Participants (DPs) to hold their shares electronically.

## Restrictions on Share Transfer by Private Companies

Private companies, even after dematerialising their shares (mandatory under new rules), still have control over share transfers as per their Articles of Association (AoA).

## Stamp Duty Amendments for Dematerialised Securities in India

- **Reduced Rates:** Amendments to the Indian Stamp Act in 2020 significantly lowered stamp duty for issuing and transferring dematerialised securities.
- **Centralised Collection:** Stamp duty is now collected centrally, eliminating multiple state-specific rates and disputes.
- **Benefits**
  - Overall lower transaction costs.
  - Private companies are not required to pay higher stamp duty on physical certificates once shares are dematerialised.

## Recommendations

### ***Private companies should:***

- Implement "checks and filters" at the depository level (e.g., freezing share codes) to enforce AoA restrictions.
- Inform depositories about their specific AoA restrictions for share transfers.

### ***Depositories should:***

- Only process share transfers based on company approval or confirmed compliance with AoA restrictions.

This ensures companies maintain control over share transfers despite the convenience of the dematerialised system.

The overall benefits outweigh the challenges, promoting a more efficient and cost-effective securities market.

## Queries?

If you have any queries about this article, please reach out to our experts:



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