Navigating Off-Market Transfer of Shares by Promoters to Non-Promoters in Listed SME Companies

Understanding Legal Nuances in Promoters' Share Transfers to Non-Promoters

A Comprehensive Legal, Regulatory & Compliance Analysis

INTRODUCTION: STRATEGIC SHARE TRANSFERS IN INDIA'S EVOLVING CAPITAL MARKET

The Indian capital market particularly the SME segment on platforms like NSE Emerge and BSE SME has rapidly matured into a sophisticated arena where promoters continually realign their shareholding strategies. Whether driven by succession planning, infusion of strategic investors, business consolidation, or corporate restructuring, the off-market transfer of shares has emerged as a preferred mechanism due to its privacy, flexibility, cost-efficiency, and ease of execution.

However, despite its operational simplicity, off-market share transfer especially from a promoter to a non-promoter is enveloped in a dense regulatory ecosystem. Compliance failures can trigger adverse consequences including penalties, reversal of transfers, open-offer obligations, and even promoter disqualification.

In the dynamic environment of Indian capital markets, promoters of listed companies often consider restructuring their shareholdings for strategic reasons such as succession planning, attracting new investors, or aligning ownership structures with long-term corporate objectives. Among the various methods available, off-market share transfer a transaction executed outside formal stock exchange trading platforms is a straightforward, discreet route for such restructuring.

This article presents a deep, structured, and practice-oriented analysis of the legal permissibility, procedural roadmap, valuation considerations, disclosure mandates, tax implications, and overarching compliance obligations governing off-market promoter transfers in SME-listed companies.

THE REGULATORY FRAMEWORK GOVERNING OFF-MARKET SHARE TRANSFERS:

Understanding the legal landscape requires familiarity with multiple statutes and regulations that collectively govern these transactions.

First, the **Companies Act, 2013**, provides the fundamental legal structure for share transfers, stipulating procedures and documentation required for valid transfer.

Second, **SEBI regulations** form the core of securities market oversight, ensuring transparency, fair practice, and investor protection.

The key SEBI regulations applicable include:

- **The SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 (ICDR)**, which set out rules on promoter lock-in, minimum promoter contribution, and lock-in periods.
- **The SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (SAST)**, which govern disclosure obligations and open offer triggers when shareholding thresholds are crossed.
- **The SEBI (Prohibition of Insider Trading) Regulations, 2015 (PIT),** which restrict trading based on unpublished price-sensitive information and mandate disclosures of trades exceeding specified thresholds.
- **The SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR),** which mandate ongoing disclosure of shareholding changes, pledges, and reclassification of promoters.
- In addition, **the Indian Stamp Act, 1899**, along with respective state stamp laws, mandates the payment of stamp duty on share transfer instruments, while **the Income-tax Act, 1961** imposes tax implications based on valuation and consideration.

Together, these laws establish a multilayered compliance regime that must be navigated carefully when executing promoter-to-non-promoter transfers.

LEGAL AND PROCEDURAL ASPECTS UNDER THE COMPANIES ACT, 2013

In recent years, the Indian securities market has transitioned to a fully demat environment, with physical share certificates now largely phased out. When shares are held in demat form, the transfer process is fundamentally different from physical share transfer. It involves electronic instructions executed through a Depository Participant (DP), acting as an intermediary between the shareholder and the depository.

When shares are held in dematerialized (demat) form, the process of transferring ownership differs significantly from physical share transfers. Instead of executing physical share transfer deeds, the transfer occurs electronically through the depository system, governed by the provisions of the Companies Act, 2013, and the rules prescribed by the Securities and Exchange Board of India (SEBI).

A. **Initiation of Demat Transfer:** In the case of demat shares, the transfer process is initiated by the shareholder submitting a **dematerialization request** or, more commonly, through the **Stock Broker or Depository Participant (DP)** who handles the transaction on behalf of the shareholder. The shareholder must **approve the transfer online** in their demat account, typically through a **Delivery Instruction Slip (DIS)** or via the depository's trading platform.

B. **Role of Depositories and Depository Participants:** India's two primary depositories — **National Securities Depository Limited (NSDL)** and **Central Depository Services Limited (CDSL)** — facilitate the electronic transfer of shares. The **Depository Participant (DP)** acts as an intermediary, akin to a bank branch, holding the shareholder's account and executing transfer instructions.

   When a promoter intends to transfer shares to a non-promoter, they must **provide a duly authorized instruction** to their DP, specifying the **number of shares** to be transferred, along with the **details of the transferee** (such as their DP account number). The DP processes this instruction electronically, and the transfer is reflected in the **shareholder's demat account**.

C. **No Physical Share Transfer Deed Required:** Unlike physical shares, where a **Form SH-4** and physical share certificates are executed and physically transferred, in the demat environment, **no physical instruments are**

involved. The transfer is effected electronically, making the process faster, more secure, and less susceptible to forgery or loss.

D. Compliance with Securities Laws and Regulations: Although the **Companies Act, 2013**, primarily governs share transfers, its provisions are now **primarily applicable to electronic transfer** when shares are in demat form. The key regulatory points include:

- **Timely processing**: The depository must process the transfer within **2 business days** of instruction receipt.
- **No stamping or physical documentation**: Since the transfer is electronic, stamp duty is applicable at the **time of the initial demat account opening** and **not** at the time of transfer.

E. Stamp Duty Implications: In demat transfers, **stamp duty** is generally **not paid** at the time of transfer, unlike physical transfers. Instead, stamp duty is paid **at the time of the initial share allotment or demat account opening**. However, in certain cases involving **off-market transfers**, the **State Stamp Laws** require that the **transfer instructions** be **duly stamped** or that **stamp duty is paid** based on the consideration, especially if the depository system recognizes such requirements under local laws. It is important for promoters to ensure that **any transfer instructions** submitted via their DP are **properly documented** and, if required, **stamped** to avoid legal disputes or invalidation.

F. Shareholder's Responsibility and Due Diligence

- The **transferring shareholder** must ensure that the **demat account** is **active**, **funded**, and **authorized** to execute transfers.
- The **transferee** must have a **valid demat account** with a registered DP to receive the transferred shares.
- Both parties must **adhere to KYC (Know Your Customer)** and other compliance requirements under SEBI regulations.

G. Impact of Lock-in and Regulatory Restrictions

- **Lock-in Periods**: If the shares are **locked-in** (e.g., MPC shares during IPO), the electronic transfer instruction will be **rejected** by the depository system until the lock-in expires.
- **Regulatory Restrictions**: Any restrictions on transfer, such as **SEBI lock-in**, **SEBI open offer triggers**, or **shareholding disclosures**, must be **complied with** before initiating the transfer.

H. Registration and Record Updating:

- The **company's Register of Members** is **updated automatically** through the depository system upon successful transfer.
- The **company** and **regulators** can verify the updated shareholding position via **depository statements** or **regulatory filings**.

Note: ***While the act facilitates the transfer, the key is ensuring compliance with other applicable regulations, especially those imposed by SEBI, which may restrict or condition such transfers, particularly during lock-in periods or in the context of promoter shareholding obligations.***

IMPACT OF SEBI REGULATIONS ON OFF-MARKET TRANSFERS

SEBI's regulatory regime introduces specific restrictions and obligations that directly influence the feasibility and legality of off-market transfers involving promoters and non-promoters.

A. LOCK-IN PROVISIONS UNDER ICDR REGULATIONS

Regulation 17 of the ICDR Regulations mandates that **promoter shareholding**, especially the **Minimum Promoter Contribution (MPC)**, must remain **locked-in** for a period of **3 years** from the date of the company's IPO.

- **Implication**: Any transfer of **locked-in promoter shares** before the expiry of this 3-year lock-in period is **illegal** and **void**.
- **Practical example**: If a company was listed two years ago, the **20% MPC shares** are still **locked-in** and **cannot be transferred** off-market during this period. Shares beyond the MPC are **free** for transfer, subject to other restrictions.

B. SHAREHOLDING THRESHOLDS AND OPEN OFFER TRIGGERS UNDER SAST

The **SAST Regulations** specify that:

- **Acquiring 25% or more** of voting shares **triggers** a **mandatory open offer** to acquire an additional **at least 26%** of shares from minority shareholders.
- **Change of control**—e.g., crossing the **50%** threshold—also triggers similar obligations.
- **Disclosures** must be made within **2 working days** of the acquisition or sale of **≥2%** of shares.

Implication for promoter-to-non-promoter transfer: If the transfer causes the **promoter's shareholding to fall below 25%**, or if the non-promoter acquires **25% or more**, an **open offer obligation** arises, which must be carefully evaluated before executing the transfer.

C. DISCLOSURE OBLIGATIONS

Any **disposal or acquisition** of **≥2%** shares must be **timely disclosed** to stock exchanges, ensuring transparency and market integrity.

- **Promoter's obligation**: To disclose such changes within **2 working days**.
- **Company's obligation**: To update its **shareholding pattern** and **disclosure** filings.

D. ENFORCEMENT AND PENALTIES

Failure to comply with SEBI's lock-in, disclosure, or takeover obligations can lead to **penalties**, **reversal orders**, or **disqualification** of promoters, along with reputational consequences.

INSIDER TRADING REGULATIONS AND THEIR IMPLICATION:

The SEBI (Prohibition of Insider Trading) Regulations, 2015 ("Insider Trading Regulations") establish a vital legal framework to promote transparency, fairness, and integrity in the securities markets. These regulations primarily restrict persons who possess **Unpublished Price Sensitive Information (UPSI)**—referred to as **insiders—**from trading in the securities of a listed entity until such information is **publicly disclosed**.

In the context of off-market transfer of shares—particularly from promoters to non-promoters—compliance with the Insider Trading Regulations is crucial to avoid violations, penalties, and reputational damage. This is especially pertinent when shares are held in **demat form**, which enables swift and electronic execution of transfers.

◇ 1. Triggers and Applicability in Share Transfers

The regulations are **triggered** when:

- The transfer involves **persons** who are **insiders** or **connected persons** at the time of transfer; or
- The transfer **relates to UPSI** in possession of the promoter or insider.

In particular:

- When a **promoter** executes an **off-market transfer** to a **non-promoter** (e.g., a third-party investor), **insider trading restrictions** may apply **if**:
  - The transfer involves **UPSI**; or
  - The promoter **possesses UPSI** at the time of transfer.

Post-Disclosure Scenario : Once UPSI is **publicly disclosed**, the **trading restrictions** are lifted, and shareholders—including promoters—are **free to trade** their securities, subject to **disclosure obligations** under applicable regulations.

Key Compliance Principles

Promoters and insiders involved in share transfers must adhere to the following core principles:

- **Confidentiality:** Maintain strict confidentiality of UPSI, ensuring that it is not disclosed or leaked.
- **Pre-transaction Assessment:** Evaluate whether the promoter possesses UPSI prior to executing any transfer.
- **Timing of Transfer:** Avoid executing the transfer **while in possession of UPSI**.
- **Public Disclosure:** Ensure UPSI is **disclosed publicly** before executing any trade or transfer that could influence market prices.
- **Post-Transfer Disclosures:** Disclose holdings if the transfer causes **crossing or falling below** specified thresholds (e.g., 5%, 10%, 15%) as per **SEBI (Substantial Acquisition and Takeover) Regulations**.

Specific Provisions Under SEBI (PIT) Regulations, 2015

- **Regulation 3(1): Prohibits** communication of UPSI to any person unless necessary for legitimate purposes, and only if confidentiality is maintained.
- **Regulation 4(1): Prohibits** trading while **in possession of UPSI**.
- **Regulation 7(2): Mandates** that promoters, directors, and designated persons **disclose trades** exceeding **₹10 lakh** in value **within 2 trading days** of the trade.
- **Regulation 9:** The **company's Code of Conduct** generally mandates **pre-clearance** for promoter and director trades, and specifies trading windows to prevent trading based on UPSI.

◇ 2. Core Principles

- **Confidentiality:** Strictly safeguard UPSI; sharing or communicating it is prohibited unless under legitimate, confidential purposes.
- **No Trading with UPSI:** Promoters and insiders **cannot** execute share transfers **while** in possession of UPSI.
- **Timely Disclosure:** Any **significant changes** in holdings (crossing thresholds) must be disclosed within **two days**.
- **Post-Disclosure Freedom:** Once UPSI is **publicly disclosed**, restrictions are lifted, allowing free trading.

Summary

- The **Insider Trading Regulations** prohibit trading based on **UPSI** and **communication of UPSI**.
- **Promoters** and **insiders** must **not** execute share transfers **while** in possession of UPSI.
- Transfer-related **disclosures** are mandatory **within two days** if holdings cross certain thresholds.
- **Public disclosure** of UPSI must precede any trading or transfer that could influence the market.
- Establishing a **compliance framework**, conducting **training**, and maintaining **strict confidentiality** are essential to uphold market integrity and avoid penalties.
- **Regulation 3(1)**: Prohibits communication of **Unpublished Price Sensitive Information (UPSI)**.
- **Regulation 4(1)**: Prohibits trading while in possession of UPSI.
- **Regulation 7(2)**: Requires **promoters, directors, and designated persons** to disclose trades if value exceeds **₹10 lakh** in a single transaction or a series in one calendar quarter. Disclosure to be made within **2 trading days**.
- **Company's Code of Conduct** (Regulation 9) usually mandates **pre-clearance** for promoter trades.

☞ ***Therefore, a promoter cannot execute an agreement or transfer while in possession of UPSI.***

◇ 3. SEBI (ICDR) Regulations, 2018 – Lock-in Provisions

- **Regulation 16**: Minimum Promoter's Contribution (MPC) shall not be less than **20% of the post-issue capital**.
- **Regulation 17(a)**: Such MPC is **locked-in for 3 years** from the date of allotment in IPO.
- **Regulation 17(b)**: Promoter's shareholding in excess of MPC shall be **locked-in for 1 year** from the date of allotment.

⚠ Any attempt to transfer MPC shares before 3 years is a **clear violation of ICDR** and will be void.

◇ 4. SEBI (SAST) Regulations, 2011 – Takeover Code

- **Regulation 3(1)**: Acquisition of shares/voting rights **≥25%** triggers a mandatory open offer for at least 26% of the total shares.
- **Regulation 3(2)**: Any acquirer holding **25% or more but less than 75%** may acquire up to **5% additional shares in one financial year** (creeping acquisition) without triggering open offer.

- **Regulation 29(1)**: Any acquisition of **2% or more** shares/voting rights must be disclosed to the stock exchange within **2 working days**.
- **Regulation 29(2)**: Any disposal of shares by promoters resulting in change of 2% or more must also be disclosed.

👉 Thus, an off-market promoter transfer to a non-promoter must be examined for **open offer triggers.**

◇ 5. SEBI (LODR) Regulations, 2015 – Disclosure Framework

- **Regulation 31(4)**: Every promoter must disclose details of pledge or encumbrance, and any change thereof, within **2 working days**.
- **Regulation 31 read with Schedule III, Part A**: Requires listed entities to disclose to stock exchanges any changes in promoter shareholding beyond **2%**.
- **Regulation 31A**: Governs reclassification of promoters to public shareholders, requiring **board approval, shareholder resolution, and stock exchange approval**.
- **Regulation 30**: Requires disclosure of **material events**, which may include a significant share transfer agreement.

◇ 6. Valuation and Pricing

(A) Valuation Report

- **Not required** for secondary transfers between Indian residents.
- Required in cases of: preferential allotment (ICDR Reg. 164), related party transactions routed through company (Companies Act, Sec. 188), or non-resident transfers (FEMA pricing guidelines).

(B) Transfer at Higher/Lower Price

- Parties may contract at any price.
- **SEBI has no floor/ceiling price for off-market transfers**.
- **Income Tax Act, 1961**:
    - Section 50CA: If consideration < Fair Market Value (FMV), FMV deemed to be full value of consideration for seller.
    - Section 56(2)(x): Buyer taxed if acquires shares at price less than FMV by more than ₹50,000.

(C) Agreements for Future Transfer

- A promoter may sign an **agreement today to transfer after 1–3 months**.
- Such agreement is enforceable under the **Indian Contract Act, 1872**, but actual ownership passes only on execution of SH-4 and entry in Register of Members.
- If agreement is material, disclosure under **LODR Reg. 30** may be triggered.
- Stamp duty is payable only at SH-4 execution stage, not on preliminary agreement.

◇ 7. Case Study

Company: ABC Tech Ltd (Listed on NSE Emerge – Sept 2023) and **Promoter (Mr. X)**: Holds 35% (35 lakh shares).

- 20% MPC (20 lakh shares) locked till Sept 2026.
- 15% balance (15 lakh shares) free since Sept 2024.

Proposed Transaction: In Sept 2025, Mr. X agrees to transfer 10 lakh shares off-market to Investor Y (non-promoter) at ₹80 (market price ₹100).

Legal Analysis:

- ✅ Transferable: Yes, since shares are outside MPC.
- ✅ Price: Valid under SEBI law, but IT Act may tax on FMV basis.
- ✅ Disclosures:
  - Mr. X's holding drops from 35% to 25%.
  - Investor Y acquires 10%.
  - Both must disclose under **SAST Reg. 29**.
- ⚠️ If Investor Y were acquiring 25%+, an open offer obligation under **Reg. 3(1), SAST** would be triggered.

COMPLIANCE CHECKLIST: STEP-BY-STEP GUIDE

Step	Action	Relevant Regulation	Timing / Due Date	Notes
1	Verify if shares are **free from lock-in**	SEBI ICDR Reg. 17	Before executing transfer	Critical to prevent illegal transfer
2	Confirm **absence of UPSI**; obtain **pre-clearance** if required	SEBI PIT Reg. 3, 4, 9	Before transfer	To avoid insider trading violations
3	Prepare and execute **Share Transfer Deed (Form SH-4)**	Sec. 56, Companies Act	On transfer date	Must be properly stamped and signed
4	Pay **stamp duty** (0.015%)	Indian Stamp Act	At the time of transfer	Ensure proper documentation
5	Register transfer in **Register of Members**	Sec. 56(4)	Within **30 days**	Company's statutory obligation
6	Disclose shareholding change (≥2%)	SAST Reg. 29	Within **2 working days**	Ensures transparency
7	Disclose high-value trades (>₹10 lakh)	PIT Reg. 7(2)	Within **2 trading days**	Promoter compliance
8	Company updates **shareholding pattern**	LODR Reg. 31	Next **quarter**	Ongoing disclosure
9	Reclassification of promoter status (if applicable)	LODR Reg. 31A	As per prescribed process	For promoter/ promoter group reclassification

FINAL OBSERVATIONS AND BEST PRACTICES:

While the off-market transfer of shares by promoters to non-promoters in a listed SME company is legally permissible, executing such transactions requires meticulous planning and strict adherence to applicable laws.

Key best practices include:

- **Secure a comprehensive legal opinion** before execution to ensure compliance.
- **Maintain detailed and organized documentation** of all steps, disclosures, and approvals.
- **Engage experienced company secretaries and tax advisors** to navigate the complexities.
- **Perform due diligence** on the lock-in status, disclosure obligations, and tax implications.
- **Monitor regulatory updates** to stay compliant with evolving SEBI and corporate laws.

Failure to comply can lead to penalties under SEBI Act, reversal of transactions, or disqualification of promoters, not to mention potential reputational harm.

CONCLUSION:

Off-market share transfers from promoters to non-promoters are fully permissible under Indian law. Yet, the regulatory ecosystem surrounding such transfers is purposefully stringent to safeguard transparency, market stability, and investor confidence especially in the fast-growing SME segment.

Success in executing such transactions lies in:

- **Understanding lock-in restrictions**
- **Navigating SAST and PIT compliance**
- **Ensuring timely disclosures under LODR**
- **Managing taxation implications**
- **Maintaining compliance discipline and documentation**

When supported by thoughtful planning and expert professional guidance, promoter share transfers can be carried out **efficiently, lawfully, and strategically** enhancing governance standards and strengthening the long-term ownership architecture of the SME entity.

Promoters and companies must therefore approach these transactions with diligence, transparency, and unwavering compliance discipline. By integrating legal, tax, and regulatory expertise at every stage, stakeholders can mitigate risks, avoid regulatory setbacks, and ensure a smooth and defensible execution of off-market share transfers.

✍ Disclaimer :

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