

BRIDGING MARKETS: LEGAL IMPLICATIONS AND SOLUTIONS FOR FRACTIONAL SHARE INVESTMENT IN INDIA

*Dhaval Bothra & Mukund Arora**

Fractional share investment has demonstrated its significance in advancing the growth and expansion of capital markets across multiple jurisdictions, as well as retail investor empowerment. In India, the regulatory framework for the clearing and settlement process of trades would necessitate technological and legal modifications to implement fractional share investment. This paper explores the legal and technological aspects of implementing fractional share investment in India. It addresses taxation, shareholder voting rights, and initial public offerings, and proposes changes to the roles of depositories and clearing houses. The paper advocates for the adoption of distributed ledger technology to facilitate fractional share investment, which will offer an efficient legal and technological model. It also examines the economic rationale and international best practices to present a comprehensive blueprint for fractional share investment in India.

TABLE OF CONTENTS

<i>I. Introduction.....</i>	<i>24</i>	<i>A.Trade Settlement And Clearing Framework.....</i>	<i>32</i>
<i>II. Assessing The Necessity And Advantages Of Fractional Share Investment In India.....</i>	<i>25</i>	<i>B.Regulatory Considerations.....</i>	<i>35</i>
<i>III. Trade Settlement And Clearing Framework For Fractional Share Investing: A Comparative Analysis..</i>	<i>27</i>	<i>VI. Fractionalisation Of Shares: The Impact On Companies.....</i>	<i>37</i>
<i>IV. The Legal Regulatory Framework In India.....</i>	<i>30</i>	<i>A.Taxation Of Fractional Shares.....</i>	<i>37</i>
<i>V. The Proposed Framework: Dlt-Based Settlement To Facilitate Share Fractionalisation</i>	<i>31</i>	<i>B.Shareholder Rights.....</i>	<i>39</i>
		<i>C.Initial Public Offerings.....</i>	<i>42</i>
		<i>VII. Conclusion.....</i>	<i>43</i>

* 4th-year students at Symbiosis Law School, Pune. All errors, if any, are solely attributable to the authors. The authors may be contacted at dhaval.bothra92@gmail.com and mukundarora9@gmail.com, respectively, for any feedback or comments.

I. INTRODUCTION

The popularity of fractional share investments has increased all around the world as internet trading platforms have grown.¹ Fractional share investing is a way to buy a portion of a stock or exchange-traded fund that is less than one full share.² This method allows investors to purchase a fraction of a share of a company's stock, making it easier to diversify their portfolio even with small amounts of money.³ This makes expensive stocks more affordable by enabling individual investors to buy a small portion of the stock. Fractional share investing is a novel idea in India, and market participants and the government have not yet assessed its implications.

Fractional shares are not allowed to be purchased, sold, or traded in India as per §4(1)(e)(i) of the Companies Act, 2013 ('the 2013 Act').⁴ The said provision states that the number of shares to which the subscribers to the memorandum of association agree to subscribe should not be less than one share. Furthermore, paragraph four of Table F provided under Schedule I to the 2013 Act prohibits the holding of fractional shares.⁵ This legal restriction limits investors' ability to hold fractional shares by requiring that the amount of share capital to which the investors agree to subscribe must not be less than one share.

While it opens up access to the stock market to more people, there are questions about the execution price and transaction transparency. The Securities and Exchange Board of India ('SEBI') has been constantly monitoring the situation of fractional share investing and may soon formulate regulations.⁶

In this context, the paper under Part II commences with the assessment of the necessity and advantages of fractional share investment in India. Part III of the paper discusses India's trade settlement and clearing framework for shares, juxtaposing it with global practices in fractional share investment. Subsequently, in Part IV, the paper scrutinises the prevailing legal landscape and the multifaceted implications of fractional share investment on various stakeholders, encompassing corporations, investors, and regulatory bodies within the Indian context. In Part V, the paper undertakes a comprehensive evaluation of diverse systems and regulatory frameworks across international jurisdictions, seeking alternative, pragmatic solutions. Additionally, it advocates for a recalibration of the roles and

¹ *Govt. Plans Framework for Fractional Shares*, THE TIMES OF INDIA, April 12, 2022, available at (Last visited on September 22, 2023).

² D. Gempesaw et al., *Piecing Together the Extent of Retail Fractional Trading*, Vol. 54, GLOBAL FINANCE JOURNAL, 7(2022).

³ Robert P. Bartlett et al., *Tiny Trades, Big Questions: Fractional Shares*, SSRN, 6 (2022).

⁴ The Companies Act, 2013, §4(1)(e)(i).

⁵ The Companies Act, 2013, Schedule I, Table F, ¶4.

⁶ *Sebi Keen to Introduce Fractional Ownership in India*, BUSINESS TODAY, September 6, 2023, available at <https://www.businesstoday.in/markets/market-commentary/story/sebi-keen-to-introduce-fractional-ownership-in-india-397060-2023-09-06> (Last visited on September 22, 2023).

relationships of depositories and clearing houses within the legal framework. A pivotal contribution lies in its proposal to reshape the existing technological infrastructure, championing the adoption of distributed ledger technology ('DLT') as a viable means to operationalise fractional share investment in India

The paper, under Part VI, extends its purview to address potential implications on taxation, shareholder voting rights, and the dynamics of offerings ('IPOs') arising from the incorporation of fractional share investment in India. Part VII offers concluding remarks. Consequently, the paper aspires to present a holistic blueprint for the implementation of fractional share investing in India, with a paramount focus on bolstering its economic feasibility.

II. ASSESSING THE NECESSITY AND ADVANTAGES OF FRACTIONAL SHARE INVESTMENT IN INDIA

DLT allows various models to facilitate fractional share investing. However, these changes must be measured against the extent of the necessity of fractional share investing in India. In India, there are merely seventeen companies that have a share price greater than Rs. 10,000.⁷ The highest-priced stock in India for the past three years (2019-2022) was MRF Ltd., which touched an all-time high at Rs. 96,973 in February, 2021.⁸ In stark contrast, there are around 661 companies in the United States of America ('USA') with a share price of up to Rs. 37,500.⁹ There are fifty-eight companies with a share price of up to Rs. 160,000 and eight companies with a share price greater than the same amount.¹⁰ Berkshire Hathaway is the most expensive single share in the USA, touching an all-time high of USD 539,180 or Rs. 44,512,813 in March, 2022.¹¹ This disparity highlights the need for a more thorough assessment of the necessity of fractional share investing in India before implementing DLT to facilitate it.¹²

⁷ Aditi Murkute, *16 Most Expensive Stocks that are Trading above Rs 10,000*, GOODRETURNS, June 13, 2023, available at <https://www.goodreturns.in/personal-finance/investment/16-most-expensive-stocks-that-are-trading-above-rs-10-000-1286061.html> (Last visited on September 22, 2023).

⁸ J. Jaganath, *MRF Share Price Crosses Rs 1 Lakh-Mark: Here's Why it's Not the Most Expensive Stock*, BUSINESS TODAY, June 13, 2023, available at <https://www.businesstoday.in/markets/company-stock/story/mrf-share-price-crosses-rs-1-lakh-mark-heres-why-its-not-the-most-expensive-stock-385420-2023-06-13> (Last visited on September 22, 2023).

⁹ Trading View, *Most Expensive US Stocks*, available at <https://in.tradingview.com/markets/stocks-usa/market-movers-most-expensive/> (Last visited on September 22, 2023).

¹⁰ *Id.*

¹¹ IND money, *Berkshire Hathaway Q2 2023 Earnings: Shares Hit All-Time-High after Operating Profits Hit \$10 Billion!*, August 8, 2023, available at <https://www.indmoney.com/articles/us-stocks/berkshire-hathaway-q2-2023-earnings-shares-hit-all-time-high-after-operating-profits-hit-10-billion> (Last visited on September 22, 2023).

¹² Groww, *Top 10 Most Expensive Stocks in India 2023*, April 27, 2023, available at <https://groww.in/blog/expensive-stocks-india> (Last visited on September 22, 2023).

Given the data, it can be derived that fractional share investing would have greater significance and utility in the USA as opposed to India. However, it also can be argued that various other economic factors including per capita income, market share of institutional investors, and inflation mitigate the power purchase parity. In countries with lower per capita income, individuals may have less disposable income to allocate towards investments, making fractional share investing less accessible. Markets can practically see rising capital infusion and market volume if investors can purchase shares with very little amount.

Mutual funds in India provide a good alternative to fractional share investing for investors who are seeking to diversify their portfolios with limited funds. However, fractional shares provide investors with direct ownership, customisation, cost-efficiency, and the flexibility to invest in high-priced stocks, enhancing their investment experience. Moreover, fractional shares allow for diversification within individual stocks, offer real-time liquidity, and support automatic dividend reinvestment. These unique advantages make fractional shares a valuable addition to India's investment landscape, complementing the convenience of mutual funds and catering to a broader range of investor preferences and objectives. This is because fractional share investing involves purchasing a portion of a stock or other securities. In contrast, when individuals buy units in a mutual fund, they become part-owners of the underlying assets, including fractional ownership of the stocks held by the fund. In the given context, mutual funds in India are specified as a unit-based investment system, as opposed to fractional share investing.¹³ Thus, when an investment is made in a mutual fund, it is the units of the fund that are being bought, rather than fractions of individual stocks or securities directly. Correspondingly, the investor indirectly holds shares purchased by the fund that are proportionally divisible among fund investors and may lead to indirect fractional ownership. Therefore, it is an existing model that facilitates investments in stocks with small amounts of money by owning fractional units of a mutual fund.¹⁴

Through the increase in the number of capital market participants, fractional share investment can increase market efficiency in India. By making it easier and more inexpensive for individual investors to participate, fractional share investing can lead to better-educated purchasing and selling decisions, which can help to ensure that prices appropriately reflect the underlying worth of companies.¹⁵

Due to India's lower average income, fractional shares can become an important investment option for retail investors. Allowing such investors to purchase smaller, more inexpensive chunks of these stocks, shall enable them to

¹³ Schwab Brokerage, *Fractional Shares*, available at <https://www.schwabmoneywise.com/essentials/fractional-shares> (Last visited on September 22, 2023).

¹⁴ The Securities and Exchange Board of India, Master Circular, *Mutual Funds*, SEBI/IMD/MC No.3/10554/2012 (Issued on May 11, 2012).

¹⁵ Brad M. Barbera & Terrance Odean, *Chapter 22: The Behavior of Individual Investors* in HANDBOOK OF THE ECONOMICS OF FINANCE, 1533-1535(2nd ed., 2023).

participate in a diversified portfolio that includes blue-chip stocks and other high-value securities.

Moreover, fractional shares give ordinary investors more freedom in their investing decisions. Since fractional shares are sold in smaller increments, retail investors can alter their portfolios more simply and with less impact on their finances. Finally, the use of fractional shares in India can serve to foster financial awareness and a savings culture.¹⁶ Brokers can assist educate and empower clients by allowing them to invest in the stock market, even with small sums.¹⁷

III. TRADE SETTLEMENT AND CLEARING FRAMEWORK FOR FRACTIONAL SHARE INVESTING: A COMPARATIVE ANALYSIS

Exploring the possibility and feasibility of fractional share investing in India requires a systematic analysis of its settlement and clearing system. The Indian securities regulation regime has evolved greatly over the years to build a safe, efficient, and robust system for market participants. However, it is not fundamentally possible to invest in fractional shares under the current system directly. This is owing to our trade settlement and clearing system. Unlike many jurisdictions, such as Canada, the United Kingdom, and Australia,¹⁸ investing necessitates the establishment of a trading and de-mat account, with securities held electronically through depositories.¹⁹ Furthermore, India does not have a street name concept, where shares can be held in the broker-dealer's name (street name) with the investor being the beneficiary. Instead, in India, all shares are directly attributed to investors' de-mat accounts, making it difficult to determine and record fractional ownership accurately.²⁰ The existing trading and clearing infrastructure operates on whole share units, settling trades based on full shares. Therefore, implementing fractional shares would necessitate significant changes to India's regulatory and market infrastructure, including reforms to accommodate partial ownership and support fractional trading and settlement, making it fundamentally challenging under the current system. The differences between Indian brokers and brokers in other jurisdictions are analysed below.

For instance, Indian brokers solely work as middlemen between clients and exchanges.²¹ However, brokers in the USA can act as both agents and dealers.²² This distinction gives USA brokers more options for executing orders, such as acting as principals or directing orders to market makers or exchanges.²³ However, paying for order flow is not practised by Indian brokers, and all orders are executed only on stock exchanges such as the National Stock Exchange ('NSE'), Bombay Stock Exchange, and Multi Commodity Exchange of India Limited.

Further, in India, the trading account is used to make orders, whilst the de-mat account is used to retain purchased securities and is accessed via a

depository or broker login.²⁴ To provide de-mat services, Indian brokers must be members of depositories such as Central Depository Services Limited ('CDSL') and National Securities Depository Limited ('NSDL').²⁵ However, the concept of de-mat is non-existent in the USA. Only a trading account is required to be opened for the USA investors, and shares can be held in the investor's name or the broker's name.²⁶ Broker-dealers can hold securities in their name and offer zero brokerage trading by generating revenue via lending securities and providing margin funding.²⁷ Clients can purchase fractional shares and trade them solely through the original broker-dealer.²⁸

Moreover, the USA Securities and Exchange Commission's National Best Bid & Offer ('NBBO') standards ensure that client transactions are conducted at fair market values.²⁹ These standards are designed to ensure that client transactions are executed at prices that reflect the fair market value of the securities being traded.³⁰ They set the highest current bid price and the lowest current ask price for a particular security across all the major stock exchanges.³¹ Brokers are required to execute client orders at prices that are in line with or better than the NBBO.³² This helps in protecting investors from receiving unfavorable prices for their trades and ensures that they get the best possible execution.³³ Due to this, brokers typically have limited exposure to market risk when executing client orders. Since brokers are obligated to execute orders at or near the prevailing market prices, they are unlikely to suffer significant losses on a single trade.³⁴ In other words, they can generally only lose the difference between the bid and ask prices (the spread) on a given trade.³⁵

²⁴ Securities and Exchange Board of India, *FAQs on Secondary Market*, available at https://www.sebi.gov.in/sebi_data/faqfiles/jan-2017/1485843476566.pdf (Last visited on September 22, 2023).

²⁵ *Id.*, 18.

²⁶ USA Securities and Exchange Commission, *Duties of Brokers, Dealers, and Investment Advisers*, available at <https://www.sec.gov/rules/other/2013/34-69013.pdf> (Last visited on September 22, 2023).

²⁷ USA Securities and Exchange Commission, *Confidential Submission of Amendment No. 1 to Draft Registration Statement on Form S-1*, available at <https://www.sec.gov/Archives/edgar/data/1783879/000162827921000280/filename1.htm> (Last visited on September 22, 2023).

²⁸ *Id.*, 18.

²⁹ Press Release, U.S. SECURITIES AND EXCHANGE COMMISSION, available at <https://www.sec.gov/news/press-release/2020-311> (Last visited on September 22, 2023).

³⁰ Schwab Brokerage, *Understanding Price Improvement*, available at <https://www.schwab.com/execution-quality/price-improvement> (Last visited on September 22, 2023).

³¹ *Id.*

³² Sida Li et al., *Refusing the Best Price?*, Vol. 147(2), JOURNAL OF FINANCIAL ECONOMICS, 317–337 (2023).

³³ *Id.*

³⁴ FINRA, *Regulatory Notice 15-46*, November 20, 2015, available at <https://www.finra.org/rules-guidance/notices/15-46> (Last visited on September 22, 2023).

³⁵ Charlotte Borsboom & Sascha Fullbrunn, *Stock Price Level Effect*, MUNICH PERSONAL REPEC ARCHIVE, August 18, 2021, available at https://mpra.ub.uni-muenchen.de/109286/1/MPRA_paper_109286.pdf (Last visited on September 22, 2023).

Brokers in the USA allow clients to purchase fractional shares based on the company's policies.³⁶ For instance, if Stock Y is priced at USD 500, a broker-dealer may permit fractional transactions in USD 10 increments (0.2 percent of the share). The broker-dealer keeps one share of Stock Y in its inventory valued at USD 500 and records partial ownership for clients via book entries. If three clients buy USD 100, USD 170, and USD 130 of Stock Y, the broker-dealer records partial ownership for each and keeps USD 100 of Stock Y in its books under its name. The maximum risk for the broker-dealer is limited to the value of one share of Stock Y, in this case, USD 500.

Fractional share trading is a popular investment option in other countries as well, such as the United Kingdom,³⁷ ('UK') Singapore,³⁸ and Japan.³⁹ Investors in these countries can purchase fractional shares of publicly listed firms through a broker or investment platform. The fractional shares are stored in the name of the broker or the platform, which also keeps an inventory of complete shares and divides them among investors to produce fractional shares.⁴⁰

The differences between India's approach to stock trading and that of other jurisdictions, particularly the USA, are stark and have significant implications for the feasibility of fractional share investing. India's securities regulation regime prioritises safety and efficiency, relying on the establishment of trading and de-mat accounts to ensure transparency and secure ownership of shares held electronically through depositories. Unlike the USA and some other countries such as Canada, the United Kingdom, and Australia, India lacks the street name concept, which complicates the precise recording of fractional ownership.⁴¹ The existing trading and clearing system in India operates on whole share units, making it challenging to accommodate fractional shares without substantial regulatory and infrastructural changes. In contrast, USA brokers enjoy more flexibility, acting as both agents and dealers and can offer zero brokerage trading through practices like payment for order flow. The NBBO standards further ensure fair market values in client transactions, limiting brokers' market risk. Further, fractional share investing is an established practice in other countries such as the UK, Singapore, and Japan, where investors can easily purchase and trade fractional

³⁶ Bankrate, *Best Brokers for Fractional Share Investing*, September 1, 2023, available at <https://www.bankrate.com/investing/best-brokers-fractional-share-investing/> (Last visited on September 22, 2023).

³⁷ Financial Conduct Authority, *Listing Rules*, available at <https://www.handbook.fca.org.uk/handbook/LR.pdf> (Last visited on September 22, 2023).

³⁸ MONETARY AUTHORITY OF SINGAPORE, Notice on Risk based Capital Adequacy Requirements for holders of Capital Markets Services Licences, SFA 04-N13, (Notified on April 3, 2013).

³⁹ Financial Services Agency, *Comprehensive Guidelines for Supervision of Financial Instruments Business Operators, etc.*, March 2023, available at https://www.fsa.go.jp/common/law/guide/kinyushohin_eng.pdf (Last visited on September 22, 2023).

⁴⁰ International Organization of Securities Commissions, *Consultation Report on Retail Market Conduct Task Force*, March 2022, available at <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD698.pdf> (Last visited on September 22, 2023).

⁴¹ *Id.*, 18.

shares through brokers or investment platforms. These jurisdictions allow for more seamless access to partial ownership, providing investors with greater flexibility and risk management options in their investment strategies.

IV. THE LEGAL REGULATORY FRAMEWORK IN INDIA

The Company Law Committee ('the Committee'), in its recent report dated March 21, 2022, acknowledged its discussion regarding the issuance and holding of fractional shares. However, it was noted that such a practice is not allowed under §4(1)(e)(i) of the 2013 Act.⁴² As mentioned before, this provision states that the number of shares to which the subscribers to the memorandum of association agree to subscribe should not be less than one share. Furthermore, paragraph four of Table F provided under Schedule I to the 2013 Act prohibits the holding of fractional shares. However, it was recognised that despite the current restrictions imposed by the 2013 Act the acceptance of fractional shares as a potential outcome of corporate actions, such as mergers, bonus issues, or rights issues, presents an opportunity for investors to participate in the capital markets.⁴³

The Committee recommended that the 2013 Act should be amended to include provisions that permit the issuance, holding, and transfer of fractional shares for specified classes of companies under prescribed regulations.⁴⁴ This recommendation aims to cater to the needs of the retail investors. Many retail investors may desire to invest in certain companies but lack the financial means to purchase whole shares, particularly when single-share units come at a high cost. By allowing the possession and trading of fractional shares, these investors would gain the ability to invest precise, budgeted amounts in companies that would otherwise be financially out of reach. Importantly, the Committee emphasises that the aforesaid provisions should only apply to fractional shares issued directly by the respective company and not to those created as a result of corporate events such as mergers.⁴⁵ It was noted that these fractional shares should only be issued in dematerialised form.⁴⁶ 'Dematerialised form' refers to the electronic representation of securities rather than physical paper certificates. When fractional shares are issued in dematerialised form, they exist as digital records within a centralised depository system, allowing for secure, efficient, and electronic tracking, trading, and ownership management of these partial stakes in companies, as opposed to traditional paper-based methods.⁴⁷

⁴² The Companies Act, 2013, §4(1)(e)(i).

⁴³ MINISTRY OF CORPORATE AFFAIRS, *Report of The Company Law Committee*, 18-19, (March, 2022) available at <https://www.mca.gov.in/bin/dms/getdocument?mds=bwsK%252FBEAFTVdpdKuv5IR5w%253D%253D&type=open> (Last visited on September 22, 2023).

⁴⁴ *Id.*

⁴⁵ *Id.*

⁴⁶ *Id.*, 40.

⁴⁷ Securities and Exchange Board of India, *FAQ – Dematerialisation*, available at https://www.sebi.gov.in/sebi_data/docfiles/20618_t.html (Last visited on September 22, 2023).

The Committee recommended that for listed companies, the regulations pertaining to the issuance and holding of fractional shares be made in consultation with the SEBI.⁴⁸ It is important to note that this recommendation is only applicable to situations involving a new issuance of fractional shares by the company and does not pertain to cases where fractional shares are temporarily created as a result of corporate actions.⁴⁹

The Committee also noted that the International Financial Services Centres Authority ('IFSCA') has recently approved the trading of fractional shares as part of its 'regulatory sandbox framework' in India.⁵⁰ This framework, overseen by the IFSCA serves as an experimental space within India's International Financial Services Centres ('IFSCs'), allowing financial institutions such as NSE IFSC to test innovative financial products and services under relaxed regulatory constraints.⁵¹ It empowers these entities to test the viability of new offerings, such as fractional share trading, while maintaining investor protection

The authorisation of fractional share trading within the regulatory sandbox framework indicates that the IFSCA supports the notion of fractional share investing in India and is working to assist its growth. However, it is crucial to remember that the acceptance of fractional shares under the regulatory sandbox is a temporary step that may not result in the permanent legalisation of fractional share trading in India. Before fractional share trading becomes a permanent fixture in the Indian financial markets, regulatory developments and actions by relevant authorities will be required. Although the results of the regulatory sandbox can be utilised to inform and influence future regulatory decisions. For instance, if a product or service is effective and has a favorable impact on the market, it is more likely to be permanently accepted.⁵²

V. THE PROPOSED FRAMEWORK: DLT-BASED SETTLEMENT TO FACILITATE SHARE FRACTIONALISATION

The current regulatory schematic in India is dependent on several separate entities to facilitate settlement and clearing functions. In this part, the discussion revolves around the integration of DLT into India's securities market. It highlights the current reliance on multiple entities for settlement and clearing

⁴⁸ *Id.*, 43.

⁴⁹ *Id.*, 40.

⁵⁰ NSE International Exchange, *NSE Newsletter – Volume 6*, available at <https://static.nseifsc.com/s3fs-public/2021-12/NSEIFSCQuarterlyNewsletterVol.6.pdf> (Last visited on September 22, 2023).

⁵¹ NSE International Exchange, *IFSC to Introduce Trading in US Stocks*, available at <https://www.nseifsc.com/media/nse-ifsc-to-introduce-trading-in-us-stocks> (Last visited on September 22, 2023).

⁵² Fintech Note, *The World Bank Group, Global Experiences from Regulatory Sandboxes*, available at <https://documents1.worldbank.org/curated/en/912001605241080935/pdf/Global-Experiences-from-Regulatory-Sandboxes.pdf> (Last visited on September 22, 2023).

processes and proposes a shared database for real-time securities ownership recording using blockchain technology. This approach aims to streamline processes, eliminate intermediaries, and enable share fractionalisation. The part also addresses the prohibition on fractional share issuance and suggests a collaborative effort among regulators, intermediaries, and technology providers to develop a blockchain-based platform for fractional shares while ensuring compliance. It emphasises the need for regulatory support and collaboration to harness DLT's potential for reshaping roles and responsibilities in the financial sector.

Fractionalisation is only technically possible with operational modifications of existing participants and their interaction, or the creation of an entirely new clearing and settlement framework.⁵³ In India, the NSE Clearing compiles trades over a specific trading period, balances out positions, and determines the obligations of members.⁵⁴ This process ensures the transfer of funds and securities to fulfil those obligations.⁵⁵ Under the prevailing infrastructure, depositories, clearing banks, and custodians engage to carry out settlement and clearing, and data vendors directly provide market data feeds for the order book and trading.⁵⁶ Currently, the NSE Clearing transfers securities to the CDSL and NSDL by way of electronic book entries.⁵⁷ Thus, the ownership of securities is recorded electronically in the books of CDSL and NSDL. The transfer of securities is done in realtime and is based on the instructions received from the member brokerages.⁵⁸

A. TRADE SETTLEMENT AND CLEARING FRAMEWORK

The fractionalisation of cryptocurrencies facilitated significant investment and gave impetus for fractionalisation in other classes of assets.⁵⁹ DLT or Blockchain technology has the potential to revolutionise capital markets transform the core of all market infrastructure and allow fractionalisation of equity shares. DLT operates as a decentralised digital ledger system where transactions are recorded and verified across a network of computers.⁶⁰ It functions by representing transactions as blocks of data, linked together in a chain, and relies on

⁵³ National Stock Exchange, *Clearing and Settlement – Equities*, available at <https://www.nseindia.com/products-services/equity-market-clearing-settlement> (Last visited on September 22, 2023).

⁵⁴ *Id.*

⁵⁵ National Stock Exchange, *NSE*, available at https://www1.nseindia.com/supra_global/content/nscl/clearing_n_set.htm (Last visited on September 22, 2023).

⁵⁶ National Stock Exchange, *Clearing and Settlement – Equities*, available at <https://www.nseindia.com/products-services/equity-market-clearing-settlement> (Last visited on September 22, 2023).

⁵⁷ National Stock Exchange, *Funds Settlement*, available at <https://www.nseindia.com/products-services/equity-market-funds-settlement> (Last visited on September 22, 2023).

⁵⁸ *Id.*

⁵⁹ Alex Pugh, *How Blockchain Technology is Opening up Fractional Investing*, November 16, 2022, FINTECH FUTURES, available at <https://www.fintechfutures.com/2022/11/how-blockchain-technology-opens-up-fractional-investing/> (Last visited on September 22, 2023).

⁶⁰ World Bank Group, *Distributed Ledger Technology (DLT) and Blockchain*, December 1, 2017, available at <https://documents1.worldbank.org/curated/en/177911513714062215/pdf/122140-WP-PUBLIC-Distributed-Ledger-Technology-and-Blockchain-Fintech-Notes.pdf> (Last visited on September 22, 2023).

consensus mechanisms to validate and add new transactions to the ledger.⁶¹ Once a transaction is added to the blockchain, it becomes nearly impossible to alter, ensuring the integrity of the ledger.⁶² This technology offers several advantages, including enhanced security through cryptography, transparency due to the open ledger system, improved efficiency with faster and lower-cost transactions, and the elimination of intermediaries.⁶³ Additionally, DLT supports smart contracts, self-executing agreements with predefined rules, further automating processes.⁶⁴ In the proposed framework, DLT is utilised to create a unified and secure ledger for securities ownership, enabling real-time updates, and automation, and reducing the need for multiple intermediaries. This technology streamlines processes, enhances transparency, and ensures compliance, making it highly beneficial for the efficient functioning of the financial sector.

While DLTs offer opportunities to create entirely new markets and establish principles supporting fractionalisation, it is important to note that in the current environment, fractionalisation can be realised by employing DLT for specific, targeted functions. Therefore, while DLT has the potential to revolutionise markets and enable various innovative solutions, its application for fractionalisation does not necessarily require a complete overhaul of existing systems. Instead, DLT can be strategically employed to address particular aspects or functions related to fractionalisation within the existing framework, allowing for a more focused and efficient implementation.

This paper proposes the implementation of a shared database for recording securities ownership, which will allow for real-time updates and eliminate the need for various intermediaries or outside infrastructure. The book entry model already exists in the current system of transfer of securities and the proposed change refers to the background technology. The utilisation of DLT in the post-trade stage facilitates the maintenance of a unified, shared, and unchanging ledger of transaction details that is updated at every stage of the process and readily accessible to all relevant parties. This would enhance the existing book entry model without disrupting established practices. DLT's implementation in the post-trade phase would allow for real-time updates to securities ownership records, eliminating the necessity for multiple intermediaries and external infrastructure. This approach leverages DLT's inherent features, including immutability and decentralisation, to maintain a unified ledger of transaction details that is continuously updated and easily accessible to all stakeholders. Thus, under the proposed framework, DLT will function as a secure and decentralised digital ledger system that accurately and transparently maintains a comprehensive record of all

⁶¹ *Id.*

⁶² Xiaoying Zheng et al., *A Survey on Challenges and Progresses in Blockchain Technologies: A Performance and Security Perspective*, Vol. 9(22), APPLIED SCIENCES J., 4-9 (2019).

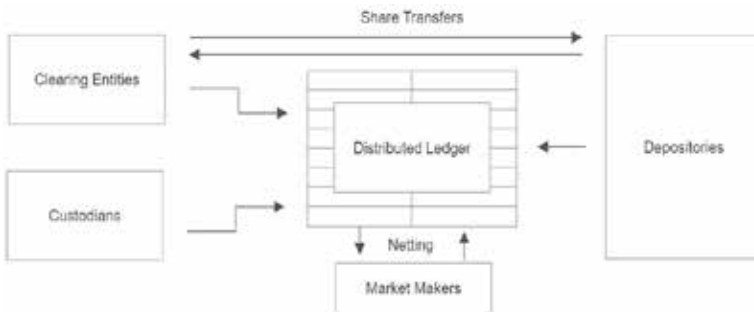
⁶³ *Id.*

⁶⁴ Christian Sillaber & Bernhard Wärtl, *Life Cycle of Smart Contracts in Blockchain Ecosystems*, Vol. 41, DATENSCHUTZ UND DATENSICHERHEIT – DuD, 497-500 (2017).

transactions and ownership of securities, ensuring efficient tracking of payment and settlement processes related to securities trades.

In such a framework, all parties that are directly involved in securities settlement should become nodes of the blockchain network, which are essentially the interaction endpoints. In the context of the Indian regulatory framework, this would include depositories, registered clearing banks, and custodians. In this system, the blockchain takes care of transferring ownership of securities and making payments at the same time. This combination allows for a “delivery versus payment” process, implying one can only obtain the securities if one has made the payment and *vice versa*. This way, it ensures that transactions involving fractions of shares are properly settled within the blockchain system. The highest risk one would face when dealing with unsold fractions of a stock would be the price of a single share. In simpler terms, it means one would not end up with only part of a stock without completing the payment, reducing risks in the process. The residual portion of the stock that has not been bought by investors can be held by the market makers. All securities traded on the stock exchanges in book-entry form are recorded in book-entry form in the ledger so they can be settled in a securities settlement system. Therefore, the clearing entities will interact with the depository via this blockchain containing transaction details, with both entities behaving as nodes. The proposed framework is further depicted in Figure-1.

Figure-1



It must be taken into account that multiple variations of DLT can be utilised for settlement. In this proposal, a general possibility of potential links between participants using DLTs is proposed. This linkage between participants using various DLTs aims to achieve compatibility and interoperability. It recognises that there are different types of DLTs available. Creating a flexible framework that allows these different DLTs to work together or link with each other, ensures that participants in the securities settlement process can choose the DLT that suits their needs while still being able to interact seamlessly with others in the same network.

Similar innovations have been made under various projects. NASDAQ Linq Blockchain Ledger Technology completed and recorded a private securities transaction in 2015.⁶⁵ Project Stella of the Bank of Japan explored the potential of DLT for improving domestic interbank payments and settlements and facilitating rapid interbank trading and settlement of securities for cash.⁶⁶ The ‘Blockbaster’ prototype of the German Central Bank experimented with DLT for various use cases, for instance, improvising efficiency and reducing liability during interbank securities settlement processes.⁶⁷ Lastly, the Monetary Authority of Singapore’s Project Ubin collaborated with the banking sector and explored DLT for the clearing and settlement of payments and securities.⁶⁸

B. REGULATORY CONSIDERATIONS

SEBI recently issued a circular on Security and Covenant Monitoring using Distributed Ledger Technology informing market participants of the development and implementation of a system for depositories to operationalise many core processes using DLT.⁶⁹ This move by the regulator highlights the significance of DLT in the financial sector and its potential for relevant use cases, as well as the intent to innovate. Additionally, the SEBI has established the regulatory sandbox framework to allow registered intermediaries to experiment with financial technology solutions on a small, live customer base within a controlled environment for a limited duration.⁷⁰ The proposed framework can be tested under a regulatory sandbox.

Additionally, the Depositories Act, 1996, (‘the 1996 Act’), the SEBI (Depositories and Participants) Regulations, 2018, and the Securities Contracts (Regulation) Act, 1956, do not prescribe the use of any specific technology by depositories or clearing corporations. Regardless, this absence of technology-specific mandates offers a significant advantage by providing flexibility and adaptability

⁶⁵ Press Release, NASDAQ, December 30, 2015, available at <https://ir.nasdaq.com/news-releases/news-release-details/nasdaq-linq-enables-first-ever-private-securities-issuance> (Last visited on September 22, 2023).

⁶⁶ Michinobu Kishi, *Project Stella and the Impacts of Fintech on Financial Infrastructures in Japan*, 1-8, ADBI WORKING PAPER SERIES 2019, available at <https://www.adb.org/sites/default/files/publication/533801/adbi-wp1017.pdf> (Last visited on September 22, 2023).

⁶⁷ Deutsche Bundesbank, BLOCKBASTER FINAL REPORT, October 25, 2018, available at <https://www.bundesbank.de/resource/blob/766672/2e2ccde1855071cb55ae97c7b025da8d/mL/2018-10-25-blockbaster-final-report-data.pdf> (Last visited on September 22, 2023).

⁶⁸ MONETARY AUTHORITY OF SINGAPORE, *Project Ubin: Central Bank Digital Money using Distributed Ledger Technology*, available at <https://www.mas.gov.sg/schemes-and-initiatives/Project-Ubin> (Last visited on September 22, 2023).

⁶⁹ Press Release, SECURITIES AND EXCHANGE BOARD OF INDIA, August 5, 2021, available at https://www.sebi.gov.in/media/press-releases/aug-2021/sebi-issues-circular-on-security-and-covenant-monitoring-using-distributed-ledger-technology-_52086.html (Last visited on September 22, 2023).

⁷⁰ Press Release, SECURITIES AND EXCHANGE BOARD OF INDIA, February 17, 2020, available at https://www.sebi.gov.in/sebi_data/attachdocs/feb-2020/1581940465942.pdf (Last visited on September 22, 2023).

within the regulatory framework. It essentially allows regulatory bodies such as SEBI to explore and implement innovative technologies such as DLT in the capital markets without the constraints of pre-defined technological requirements. SEBI's circular on Security and Covenant Monitoring using Distributed Ledger Technology and the establishment of a regulatory sandbox by the NSE further underscore the regulatory intent to foster innovation in the financial sector. This leeway within the existing regulatory framework enables authorities to integrate DLT and other emerging technologies as they see fit, accommodating technological advancements and promoting efficiency in financial processes while ensuring compliance with regulatory standards and objectives.

However, the fractionalisation of shares can only be implemented under a framework designed and approved by the regulators. The prohibition concerning the issuance of shares in fractions under §4(1)(e)(i) of the 2013 Act can be effectively addressed by a collaborative initiative between the regulatory bodies, market intermediaries, and technology providers. This would entail the development of a blockchain-based platform tailored for the issuance and trading of fractional shares. Companies wishing to offer fractional shares would register on the platform, where their shares would be tokenised into blockchain assets representing fractional ownership. Investors could access the platform through registered intermediaries, while smart contracts on the blockchain would automate issuance, trading, and settlement processes, ensuring compliance with legal requirements such as voting rights and dividends. Enhanced security measures, such as biometric authentication, could be implemented, alongside educational resources for investors.

A DLT-specific law is not necessary any more than a law to govern the use of traditional operating systems. Participants must ensure that irrespective of the technology utilised, they continue to meet their existing regulatory obligations under various statutes and SEBI guidelines. For instance, §19A of the 1996 Act mandates depositories to maintain a book of account of records, which is not hindered by the implementation of DLT.⁷¹ Further, in relation to §7, when a participant initiates the transfer of securities, DLT can instantly record and confirm this transaction on the distributed ledger. The DLT platform ensures that this registration process is transparent, tamper-proof, and immediately accessible to all relevant parties. Participants, depositories, and regulators can use DLT to verify the transfer of securities, adhering to the requirements outlined in §7 of the 1996 Act.⁷² Moreover, with respect to §12, when a beneficial owner intends to create a pledge or hypothecation for securities held in a depository, they can initiate this process on a DLT platform. DLT enhances efficiency by enabling the owner to obtain prior approval from the depository transparently and securely. Once approval is granted, the DLT system records this transaction, generating immediate and immutable entries in its distributed ledger. This streamlines the pledge or hypotheca-

⁷¹ The Depositories Act, 1996, §19 A.

⁷² *Id.*, §7.

tion process and ensures compliance with regulatory obligations while providing a transparent and tamper-proof record of the transaction, aligning seamlessly with §12 of the 1996 Act.⁷³

A technological change in background systems should be supported by regulatory instruction in case it also alters the very role of existing entities, which may be likely in the instant case. This is because with DLT's implementation, traditional processes, such as security and covenant monitoring, issuance and transfer of securities, and pledge or hypothecation of assets, can be streamlined and automated on a transparent and tamper-proof blockchain platform. This shift could potentially redefine the roles and responsibilities of regulatory bodies, intermediaries, and technology providers. However, to completely realise the potential of this technology, it will require a concerted effort from regulators and policy-makers to collaborate and take the necessary steps to close these gaps.⁷⁴

VI. FRACTIONALISATION OF SHARES: THE IMPACT ON COMPANIES

The fractionalisation of shares will have an unprecedented impact on the issuing companies in various forms. It may be poised to bring about a major shift in the way issuing companies operate and raise capital. Potentially, the impact of fractionalisation will be far-reaching and multifaceted, requiring careful consideration and strategic planning by companies to navigate this change. This part discusses the consequences of the fractionalisation of shares within the corporate landscape. It focuses on the taxation of fractional shares, shareholder rights and IPO.

A. TAXATION OF FRACTIONAL SHARES

Under the Income Tax Act, 1961, selling stock results in capital gains that are subject to taxation, with short-term gains (from shares held for under thirty-six months) being taxed as ordinary income and long-term gains (from shares held for over thirty-six months) being taxed at a reduced rate of twenty percent with indexation benefits.⁷⁵ Further, under §43, securities transaction tax must be paid on the sale of shares, and dividends received from shares are taxable as income.⁷⁶

⁷³ *Id.*, §12.

⁷⁴ John Salmon & Gordon Myers, *Blockchain and Associated Legal Issues for Emerging Markets*, January, 2019, available at <https://www.ifc.org/wps/wcm/connect/da7da0dd-2068-4728-b846-7cffe1fd24a/EMCompass-Note-63-Blockchain-and-Legal-Issues-in-Emerging-Markets.pdf?MOD=AJPERES&CVID=mxocw9F> (Last visited on September 22, 2023).

⁷⁵ The Income Tax Act, 1961, §§111A & 112A.

⁷⁶ *Id.*, §43.

Different tax regulations for fractional shares as against full shares can impact investors and traders' tax obligations. An increase in overall share trading volume can affect government tax collection. For instance, fractional shares are taxed as regular stock investments in the USA with capital gains taxes paid for earnings or losses.⁷⁷

It is proposed that India ought to develop its taxation system for fractional shares while keeping other countries' taxation systems in mind. Since India has a progressive income tax structure, its taxation system is comparable to that of many other countries. To understand this better, the paper will refer to Australia as an example, which follows a progressive income tax structure. In Australia, fractional shares are taxed in the same way as ordinary stock investments, and any profits or losses realised from the sale of fractional shares are subject to capital gains tax.⁷⁸ The taxation of fractional shares is based on the 'principle of income equivalence'.⁷⁹ This principle refers to the idea that taxpayers should be taxed on their actual economic income or economic benefit, rather than just their nominal or cash income.⁸⁰ This principle aims to ensure that all forms of income, including non-cash benefits and gains, are subject to taxation fairly and equitably.⁸¹ The Australian Taxation Office ('ATO') considers fractional shares to be property and applies the same capital gains tax regulations as other types of property.⁸² The purchase price of fractional shares is considered by the ATO to represent the price paid for the fractional shares, and any capital gain or loss from the selling of fractional shares is computed based on the difference between the purchase price and the sale price of the fractional shares.⁸³

This approach ensures that all forms of income, including gains from fractional shares, are subject to taxation, promoting fairness within the tax system.⁸⁴ It also maintains consistency by applying the same capital gains tax regulations to fractional shares as to other types of property, simplifying tax procedures for both taxpayers and authorities. This transparency in taxation, based on the difference between the purchase and sale prices of fractional shares, will also gen-

⁷⁷ U.S. Securities and Exchange Commission, *Legal Opinion of Powell Goldstein LLP Regarding Certain Tax Matters*, August 22, 2006, available at <https://www.sec.gov/Archives/edgar/data/742054/000119312506177811/dex82.htm> (Last visited on September 22, 2023).

⁷⁸ Australian Tax Office, *Share Investing Versus Share Trading*, available at: <https://www.ato.gov.au/Individuals/Capital-gains-tax/Shares-and-similar-investments/Share-investing-versus-share-trading/> (Last visited on September 22, 2023).

⁷⁹ The Organization for Economic Cooperation and Development, *Fundamental Principles of Taxation in Addressing the Tax Challenges of the Digital Economy*, 2014, available at <https://doi.org/10.1787/9789264218789-5-en> (Last visited on September 22, 2023).

⁸⁰ A. J. Auerbach, *Tax Equivalences and Their Implications*, Vol. 33, TAX POLICY AND THE ECONOMY, 81–107 (2019).

⁸¹ *Id.*, 78.

⁸² Australian Taxation Office, *Investing in Shares*, available at <https://www.ato.gov.au/Individuals/Investments-and-assets/Investing-in-shares/Owning-shares/> (Last visited on September 22, 2023).

⁸³ *Id.*, 80.

⁸⁴ W.R. Lam, *Modernizing the Tax Policy Regime in MODERNIZING CHINA*, 36-38 (2017).

erate revenue for the government, thereby contributing to economic development. Additionally, such a taxation system can incentivise investment in financial markets by providing clarity and predictability in tax liabilities. By aligning with international practices, India can foster cooperation in the global financial arena, simplify tax compliance and enforcement efforts, and adapt to modern investment trends effectively.

B. SHAREHOLDER RIGHTS

Shareholders with voting rights can participate in important decisions such as selecting the board of directors, approving big transactions, and changing the company's governance structure.⁸⁵ Shareholders may desire more ownership and involvement with the company if they have voting rights. However, when it comes to fractional voting power, several challenges arise. The value of fractional voting power may be hard to determine and may not provide a significant impact on decision-making, making it difficult to determine its value in share transactions.⁸⁶ For instance, in some cases, fractional voting rights may not exert a substantial impact on the overall outcomes of shareholder votes. This makes it challenging to assign a clear and easily quantifiable value to fractional voting rights in share transactions. Moreover, the influence of fractional voting power may vary significantly depending on the specific corporate governance structure and the voting thresholds required for various decisions. For instance, in some cases, fractional voting rights may be more symbolic than substantial, as they may not provide the holder with sufficient leverage to sway major decisions or board elections.

It is recommended that a comparable structure be applied to the SEBI's framework for issuing Differential Voting Rights ('DVR') shares.⁸⁷ SEBI created these guidelines and regulations to regulate the issuance of shares having different voting rights.⁸⁸ Companies can issue shares with fewer voting rights than ordinary shares under this structure.⁸⁹ These DVR shares enable companies to obtain cash while maintaining control, as holders of these shares have limited voting rights on company-related issues.⁹⁰ The framework specifies the eligibility crite-

⁸⁵ Sakate Khaitan et al., *Shareholders' Rights in Private and Public Companies in India: Overview*, PRACTICAL LAW, available at [https://uk.practicallaw.thomsonreuters.com/7-615-1126?transitionType=Default&contextData=\(sc.Default\)&firstPage=true](https://uk.practicallaw.thomsonreuters.com/7-615-1126?transitionType=Default&contextData=(sc.Default)&firstPage=true) (Last visited on September 22, 2023).

⁸⁶ Press Release, SECURITIES AND EXCHANGE BOARD OF INDIA, available at https://www.sebi.gov.in/sebi_data/investors/assistance/rights-responsibilities/rights-and-responsibilities.pdf (Last visited on September 22, 2023).

⁸⁷ Press Release, SECURITIES AND EXCHANGE BOARD OF INDIA, August 2019, available at https://www.sebi.gov.in/sebi_data/meetingfiles/aug-2019/1565346231044_1.pdf (Last visited on September 22, 2023) ('DVR Framework').

⁸⁸ *Id.*, 85.

⁸⁹ THE HINDU BUSINESS LINE, *Now Companies Can Have 'Differential Voting Rights'*, November 1, 2021, available at <https://www.thehindubusinessline.com/business-laws/now-companies-can-have-differential-voting-rights/article37269025.ece> (Last visited on September 22, 2023).

⁹⁰ DVR Framework, *supra* note 87.

ria, pricing, and other terms and circumstances for the issuance of DVR shares.⁹¹ Eligibility criteria for companies seeking to list shares with DVR Shares under the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2013, necessitates that the company in question must be technology-intensive, specialising in fields such as information technology, intellectual property, data analytics, biotechnology, or nanotechnology, to provide products or services with substantial value addition.⁹² Additionally, the collective net worth of the promoter group to whom DVR Shares are issued must not exceed Rs. 5000 million, with the DVR Shares authorised only for promoters holding executive positions.⁹³ The issue of DVR Shares should be sanctioned through a special resolution of the shareholders, specifying key details.⁹⁴ These shares must be held for a minimum of six months before the filing of the red herring prospectus, and their voting rights can range from a minimum of 2:1 to a maximum of 10:1 vote.⁹⁵ Furthermore, DVR Shares must have the same face value as ordinary shares, and a company should have only one class of DVR Shares.⁹⁶

While DVR Shares are essentially on par with ordinary equity shares, enjoying equivalent rights, especially in terms of dividends (except for voting), they are subject to a limitation where the aggregate voting rights of DVR Shareholders, including their ordinary shares, must not exceed seventy-four percent.⁹⁷ Furthermore, post-listing, the issuing company is prohibited from granting shares that provide any person with superior or inferior dividend rights compared to existing listed equity shares or inferior voting rights compared to the rights of already listed equity shares.⁹⁸ However, bonus or rights issuances may be extended to DVR Shares, ensuring they have equivalent rights to existing DVR Shares.⁹⁹ Notably, shareholders holding DVR Shares cannot transfer their shares to others during a rights issue.¹⁰⁰ Following an IPO, DVR Shares transition to being treated as ordinary shares for various voting matters, including control transfers by promoters, related party transactions, and amendments to the company's charter documents, except those specifically affecting DVR Shares.¹⁰¹

⁹¹ *Id.*

⁹² Securities and Exchange Board of India, *Consultation Paper on Issuance of shares with Differential Voting Rights*, March, 2019, available at https://www.sebi.gov.in/reports/reports/mar-2019/consultation-paper-on-issuance-of-shares-with-differential-voting-rights_42432.html (Last visited on September 22, 2023).

⁹³ DVR Framework, *supra* note 87, 3.

⁹⁴ *Id.*, 4.

⁹⁵ *Id.*, 14.

⁹⁶ *Id.*, 5.

⁹⁷ *Id.*, 8.

⁹⁸ *Id.*, 20.

⁹⁹ *Id.*, 16.

¹⁰⁰ *Id.*, 7.

¹⁰¹ *Id.*

DVR Shares face a lock-in period post-IPO.¹⁰² This lock-in continues until either their conversion into ordinary shares or three years from the commencement of commercial production or the allotment date in the IPO, whichever comes later.¹⁰³ During this time, transferring DVR Shares among promoters is not allowed, and these shares cannot be used as collateral or subjected to liens.¹⁰⁴ DVR Shares can be converted into ordinary equity shares under two circumstances: *first* –time-based, occurring on the fifth anniversary of listing, with a potential extension by another five years through a resolution in which DVR shareholders do not participate.¹⁰⁵ However, the type of resolution (special or ordinary) is unspecified in the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.¹⁰⁶ *Second*– event-based, triggered by the holder’s demise, resignation, or a merger or acquisition where control over DVR Shares is relinquished.¹⁰⁷

In fractional share investing, full voting rights cannot be granted as fractional ownership does not equate to full ownership. Allocation of voting rights for fractional shares should be evaluated based on specific circumstances, taking the DVR framework as a reference. However, the allocation of voting rights for fractional shares should be carefully evaluated based on unique circumstances. These unique circumstances encompass specific and individual factors that may vary from one fractional ownership situation to another. Four such unique circumstances are discussed herein under.

First, the extent of fractional ownership. The critical factor in understanding the importance of the extent of fractional ownership lies in recognising the diverse scales at which shareholders may hold fractions of a share. Within this spectrum, some shareholders may have minuscule ownership stakes, representing only a fraction of a complete share, while others may command more substantial portions of the total ownership. When it comes to the allocation of voting rights, this variation in ownership percentage holds paramount significance. It is vital to consider this disparity because it has the potential to exert a profound impact on the decision-making processes within the company. Shareholders with larger fractional stakes wield more substantial influence, potentially swaying crucial decisions in a particular direction. In contrast, those with minute ownership fractions may have limited sway over corporate matters.

Second, corporate governance structure of the company. The corporate governance structure plays a pivotal role in voting rights allocation, especially in companies with intricate frameworks involving multiple classes of shares, including those with differential voting rights. These multifaceted structures

¹⁰² *Id.*, 5.

¹⁰³ *Id.*

¹⁰⁴ *Id.*

¹⁰⁵ *Id.*

¹⁰⁶ Nishith Desai Associates, *Another Step Forward by India Inc: DVR Shares*, September 13, 2019, available at <https://nishithdesai.com/generateHTML/4549/4> (Last visited on September 22, 2023).

¹⁰⁷ DVR Framework, *supra* note 87, 7.

introduce complexities that demand careful consideration when distributing voting rights. Within such systems, shareholders may hold shares with varying degrees of voting power, ranging from full rights to limited influence. Consequently, the allocation of voting rights must navigate these intricacies by not only assessing ownership percentages but also accounting for the distinct voting privileges associated with different share classes.

Third, shareholder agreements or specific contractual arrangements among fractional shareholders. The significance of shareholder agreements or specialised contractual arrangements among fractional shareholders lies in their potential to shape the allocation of voting rights in distinctive ways. These agreements introduce a layer of complexity that may deviate from the conventional voting rights framework. They can confer specific privileges, restrictions, or conditions on certain fractional shareholders, creating a nuanced landscape where voting rights allocation is influenced not solely by ownership percentages but also by the contractual terms and conditions outlined in these agreements.

Fourth, company performance and specific events. The allocation of voting rights within a corporate structure is a dynamic facet of corporate governance influenced by company performance and transformative events such as mergers, acquisitions, or shifts in corporate strategy. Company performance encompasses a wide spectrum of financial, operational, and strategic metrics, including revenue growth, profitability, and market share. Exceptional performance may lead shareholders to seek increased influence through voting rights, asserting their contribution to the company's success. Conversely, in times of performance decline, shareholders may aim to protect their interests by safeguarding voting rights from dilution. Transformative events like mergers and acquisitions can reshape ownership and governance structures, necessitating discussions about voting rights to align with the evolving corporate landscape. Similarly, changes in corporate strategy may prompt re-evaluations to ensure voting rights align with new business goals.

C. INITIAL PUBLIC OFFERINGS

IPOs are a critical event in a company's life cycle since they signal the transition from privately held to publicly traded. In numerous ways, fractional shares can influence IPOs. To begin with, fractional shares enable more people to invest in IPOs and own a piece of the company.¹⁰⁸ This benefits both the company and the investor because it increases capital and helps to diversify risk. Moreover, fractional shares allow small retail investors who would otherwise be unable to purchase a whole share due to high prices to participate in IPOs.¹⁰⁹

¹⁰⁸ Elizabeth Gravier, *Fractional Shares Allow You to Own Part of a Big-Name Stock Without the Large Price Tag*, CNBC, May 21, 2022, available at <https://www.cnbc.com/select/fractional-shares/> (Last visited on September 22, 2023).

¹⁰⁹ Robert P. Bartlett et al., *A Fractional Solution to a Stock Market Mystery*, SSRN. 3-6 (2022).

Lastly, traditional IPOs issue shares in complete units, and the minimum investment amount can be substantial, making the offering inaccessible to smaller investors.¹¹⁰ A company can offer fractional shares in smaller denominations, making the investment more accessible to a broader variety of investors. This may raise demand for the IPO, resulting in a better valuation for the company.¹¹¹

The potential to expand the accessibility of IPOs is a lucrative offer. However, the implementation may necessitate adjustments to the underlying technology and systems, as well as regulatory framework adaptations. The potential adjustments required are discussed below. *First*, from a technological standpoint, the existing trading and settlement systems would need to be modified to accommodate the trading of fractional shares seamlessly. This would include upgrades to trading platforms, order execution mechanisms, and settlement processes to ensure accurate tracking and recording of fractional ownership. Furthermore, the introduction of fractional shares might require enhancements in brokerage platforms, including the development of user-friendly interfaces that facilitate the buying and selling of fractional shares.

Second, in terms of regulatory adjustments, SEBI would have to establish clear guidelines and rules for the issuance, trading, and settlement of fractional shares to ensure investor protection and market integrity. This might involve revisiting existing regulations and amending them to specifically address the nuances of fractional ownership, including disclosure requirements, voting rights, and taxation, as addressed above in this part.

Third, in relation to the risk management protocols, market participants, including brokerage firms, would need to implement risk management protocols to address the unique challenges posed by fractional share trading, such as ensuring fair pricing, handling fractional dividends, and managing the voting process for fractional shareholders.

VII. CONCLUSION

In India, fractional share investing can provide retail investors with an opportunity to invest in high-priced stocks, even with limited finances. Allowing individuals to purchase a portion of the stock, lowers the barrier to entry into the world of stock trading and investing. This provides a wider segment of the public with the ability to invest and build wealth in the financial markets.

With technological advancements and increasing demand for accessible financial products, the authors believe that fractional shares are poised to be the future of investment in India. Regulated financial intermediaries, combined

¹¹⁰ *Id.*

¹¹¹ Zhi Da et al., *Fractional Trading*, UNIVERSITY OF NOTRE DAME, 33-35 (2023).

with technology, ensure secure and safe transactions. This enhances user convenience, supports market growth, and increases financial literacy.

The paper discusses the concept of fractionalisation of shares within India's legal and regulatory framework, primarily focusing on its implications for companies. It advocates for amending the 2013 Act to allow the issuance and trading of fractional shares, with a specific focus on serving the needs of retail investors. The proposal recommends close collaboration with SEBI and emphasises the adoption of DLT for secure and efficient fractional share trading. Additionally, the paper underscores the importance of establishing a taxation system for fractional shares, inspired by international models. It discusses the allocation of voting rights for fractional shares, drawing from SEBI's framework for DVR shares. Finally, it highlights the potential impact of fractionalisation on IPOs and the need for technological, regulatory, and risk management adjustments to accommodate fractional share trading within the IPO process.

Through the introduction of fractional shares, India can create a level playing field for all investors and help bridge the gap between them and the financial markets. Overall, fractional share investing can promote the growth of the country's financial markets while also providing equal investment options, making it a step in the right direction.