CHAPTER 4

SHARE CAPITAL AND DEBENTURES

LEARNING OUTCOMES

At the end of this chapter, you will be able to:

- Know about the Kinds of Share Capital
- Explain the basic requirements for issue of Share Certificates, Voting Rights and Variation of Shareholders' Rights
- Explain Calls on Unpaid Shares
- Know about the Time Period permitted for delivery of Certificates of Securities
- Understand the application of Securities Premium Amount
- Identify prohibition on issue of Shares at a Discount
- Understand the issue of Sweat Equity Shares, Issue and Redemption of Preference Shares and creation of Capital Redemption Reserve Account
- Know about the Transfer and Transmission of Securities, Refusal to Register and Appeal against Refusal
- Explain the concepts relating to the Alteration of Share Capital and Notice to Registrar thereof
- Understand the concept relating to Further issue of Share Capital
- Know about the issue of Bonus Shares, Reduction of Share Capital, Buy-Back of Shares and applicable restrictions thereon
- Know about issue of Debentures and creation of Debenture Redemption Reserve Account
- Identify the Punishments and penalties for various offences including impersonation.

CHAPTER OVERVIEW

Share Capital and Debentures (Sections 43-72*)	
Concepts relating to Shares (Sections 43-70 [*excluding sections 44, 45, 60 and 65*])	Concepts relating to Debentures (Section 71)

*Sections 44, 45, 60, 65 and 72 are not applicable for students.

1. INTRODUCTION

Finance, the lifeblood for running the affairs of a company, can be raised, *inter-alia,* by issuing shares and debentures. In fact, shares and debentures are financial instruments which help in arranging funds for the company. Under the Companies Act, 2013, they are jointly referred to as "securities".

Shares represent ownership interest in a company with entrepreneurial risks and rewards whereas debentures depict lenders' interest in the company with limited risks and returns.

Sometimes, after the issue of capital, a company may either alter or reduce the share capital depending upon the exigencies of the situation. The company has to follow the requisite provisions for alteration or reduction of share capital.

Both the shares and debentures are presented in the Balance Sheet on the liabilities side of the issuer company and on the assets side of the investor and lender respectively.

Legal provisions relating to these instruments are covered under Chapter IV of the Companies Act, 2013 (comprising sections 43 to 72) and the *Companies (Share Capital & Debentures) Rules, 2014* as amended from time to time along with endorsement in the company formation documents or approved at the suitable company forum, wherever necessary.

2. SHARE CAPITAL-TYPES [SECTION 43[1]]

(1) Definition of Share and Stock: Section 2(84) defines share as a share in the share capital of a company and includes stock.

The share capital of a company is divided into small units having a certain face value. Each such unit is termed as **share**.

Example 1: Sun Bakers Limited has authorised share capital of ₹ 50.00 lacs. The face value of each unit of capital or 'share' is ₹ 10. In this case, it can be said that the company has 5.00 lacs shares of ₹ 10 each. When these shares (either in part or whole) are allotted to various persons, they, on the date of allotment, become shareholders of the company.

The definition of 'share' states that the term 'share' includes **'stock'**. If a company undertakes to aggregate the fully paid up shares of various members as per their requests and merge those shares into one fund, then such fund is called 'stock'. In simple words we can say that 'stock' is a collection or bundle of fully paid-up shares. According to Section 61 (1) (c), a limited company having a share capital, after completing certain formalities, can convert all or any of its fully paid-up shares into stock, and reconvert that stock into fully paid-up shares of any denomination. Stock is stated in lump sum whereas a 'share' being the smallest unit is having face value. Originally shares are issued to the shareholders while in case of stock, the fully paid-up shares of the members are converted into 'stock' afterwards. Thus 'stock' is not issued originally but is obtained by conversion of fully paid-up shares.

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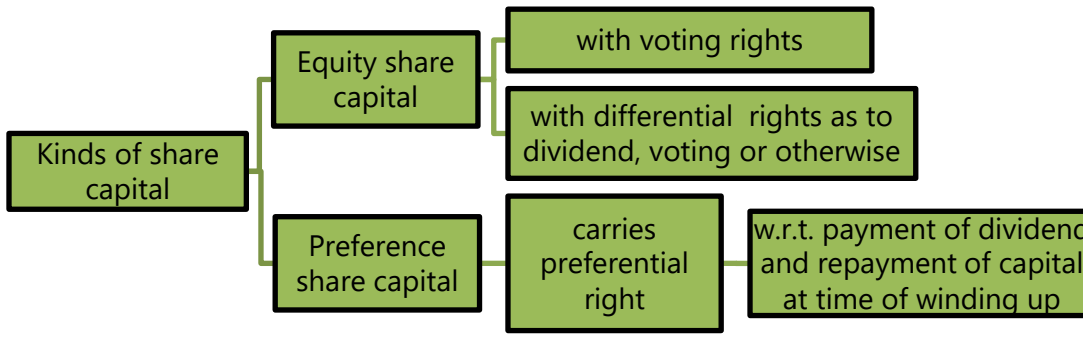
[1]Section 43 shall not apply to a:
(a) private company, where memorandum or articles of association of the private company so provides. However, the exemption shall be applicable to a private company which has not committed a default in filing its financial statements under section 137 or annual return under section 92 with the Registrar. (*Notification No. GSR 464 (E), dated 5th June, 2015 as amended by Notification No. GSR 583 (E), dated 13th June, 2017.)*
(b) Specified IFSC Public Company, where memorandum of association or articles of association of such company provides for it. - (*Notification No. GSR 8 (E), dated 4th January, 2017.)*

Following diagram depicts kinds of share capital:



(2) Two Kinds of Share Capital: Broadly, there are two kinds of share capital of a company limited by shares:

- Equity share capital
- Preference share capital.

The Act defines **preference share capital** as instruments which have preferential right to dividend payment (absolute/fixed or ad-valorem/ %) and preferential repayment during winding up of the company. These shareholders can also participate in equity pool post the preferential entitlements.

Shares which are not preference shares are termed as **equity shares**.

Equity shares are further classified as plain vanilla (same voting rights) or differential equity shares (differential with respect to dividend or voting rights or otherwise).

According to **Section 43**, the share capital of a company limited by shares shall be of two kinds, namely:—

(a) equity share capital—

(i) with **voting rights**; or

(ii) with **differential rights** as to dividend, voting or otherwise in accordance with such rules as may be prescribed[2]; and

(b) preference share capital

[2]Refer Rule 4 of the *Companies (Share capital and Debenture) Rules, 2014.*

Note: Nothing contained in this Act shall affect the rights of the preference shareholders who are entitled to participate in the proceeds of winding up before the commencement of this Act.

Explanation—For the purposes Section 43,—

(i) "**equity** share capital", with reference to any company limited by shares, means all share capital which is not preference share capital;

(ii) "**preference** share capital", with reference to any company limited by shares, means that part of the issued share capital of the company which carries or would carry a preferential right with respect to—

(a) payment of **dividend**, either as a fixed amount or an amount calculated at a fixed rate, which may either be free of or subject to income-tax; and

(b) **repayment**, in the case of a **winding up or repayment of capital**, of the amount of the share capital paid-up or deemed to have been paid-up, whether or not, there is a preferential right to the payment of any fixed premium or premium on any fixed scale, specified in the memorandum or articles of the company;

(iii) capital shall be deemed to be preference capital, notwithstanding that it is entitled to either or both of the following rights, namely:—

(a) that in respect of dividends, in addition to the preferential rights to the amounts specified in sub-clause (a) of clause (ii), it has a right to participate, whether fully or to a limited extent, with capital not entitled to the preferential right aforesaid;

(b) that in respect of capital, in addition to the preferential right to the repayment, on a winding up, of the amounts specified in sub-clause (b) of clause (ii), it has a right to participate, whether fully or to a limited extent, with capital not entitled to that preferential right in any surplus which may remain after the entire capital has been repaid.

(3) Equity Shares with Differential Rights

Rule 4 of the *Companies (Share capital and Debenture) Rules, 2014* contains provisions which need to be followed while issuing equity shares with differential rights. These are stated as under:

(i) Conditions for the issue of equity shares with differential rights: According to Rule 4 (1), a company limited by shares may issue equity shares with differential rights as to dividend, voting or otherwise, if it complies with the

following conditions, namely:

(a) the articles of association of the company authorizes the issue of shares with differential rights;

(b) the issue of shares is authorized by an ordinary resolution passed at a general meeting of the shareholders.

Where the equity shares of a company are listed on a recognized stock exchange, the issue of such shares shall be approved by the shareholders through postal ballot;

(c) the voting power in respect of shares with differential rights of the company shall not exceed seventy-four per cent of total voting power including voting power in respect of equity shares with differential rights issued at any point of time;

(d) Omitted;

(e) the company has not defaulted in filing financial statements and annual returns for three financial years immediately preceding the financial year in which it is decided to issue such shares;

(f) the company has no subsisting default in the payment of a declared dividend to its shareholders or repayment of its matured deposits or redemption of its preference shares or debentures that have become due for redemption or payment of interest on such deposits or debentures or payment of dividend;

(g) the company has not defaulted in payment of the dividend on preference shares or repayment of any term loan from a public financial institution or State level financial institution or scheduled Bank that has become repayable or interest payable thereon or dues with respect to statutory payments relating to its employees to any authority or default in crediting the amount in Investor Education and Protection Fund to the Central Government;

Provided that a company may issue equity shares with differential rights upon expiry of five years from the end of the financial Year in which such default was made good.

(h) the company has not been penalized by Court or Tribunal during the last three years of any offence under the Reserve Bank of India Act, 1934 (RBI), the Securities and Exchange Board of India Act, 1992 (SEBI), the Securities

Contracts Regulation Act, 1956 (SCRA), the Foreign Exchange Management Act, 1999 (FEMA) or any other special Act, under which such companies being regulated by sectoral regulators.

(ii) Contents of Explanatory statement: Rule 4 (2) states that the explanatory statement to the annexed to the notice of the general meeting or of a postal ballot shall contain various matters like particulars of the issue including its size, details of differential rights, etc.

(iii) Restriction on conversion of equity share capital with voting rights into equity share capital carrying differential voting rights: Rule 4 (3) specifies that the company shall not convert its existing equity share capital with voting rights into equity share capital carrying differential voting rights and *vice versa*.

(iv) Disclosure in the Board's Report: According to Rule 4 (4), the Board of Directors shall, *inter-alia*, disclose the specified particulars in the Board's Report for the financial year in which the issue of equity shares with differential rights was completed.

(v) Rights to the holders of the equity shares with differential rights: Rule 4 (5) states that the holders of the equity shares with differential rights shall enjoy all other rights such as bonus shares, rights shares, etc., which the holders of equity shares are entitled to, subject to the differential rights with which such shares have been issued.

(vi) Particulars of shares to be maintained in the register of members: Rule 4 (6) provides that where a company issues equity shares with differential rights, the Register of Members maintained under section 88 shall contain all the relevant particulars of the shares so issued along with details of the shareholders.

3. CERTIFICATE OF SHARES [SECTION 46]

A certificate of shares is required when shares are issued in physical form. Section 46 contains provisions which regulate certificate of shares. They are stated as under:

(1) Share Certificate is *prima facie* evidence of title: According to section 46 (1), a certificate, issued under the common seal[3], if any, of the company or signed

[3]Now it is optional for a company to have a common seal in terms of Proviso *(inserted by the Companies (Amendment) Act, 2015, w.e.f. 29-05-2015)* to Section 22 (2).

by two directors or by a director and the Company Secretary, wherever the company has appointed a Company Secretary, specifying the shares held by any person, shall be *prima facie* evidence of the title of the person to such shares.

(2) Issue of Duplicate Certificate: Section 46 (2) states that a duplicate certificate of shares may be issued, if such certificate —

(a) is proved to have been lost or destroyed; or

(b) has been defaced, mutilated or torn and is surrendered to the company.

(3) Manner of Issue of Certificates/Duplicate certificates: According to section 46 (3), notwithstanding anything contained in the articles of a company, the manner of issue of a certificate of shares or the duplicate thereof, the form of such certificate, the particulars to be entered in the register of members and other matters shall be such as may be prescribed[4].

(4) Shares held in Depository Form: According to Section 46 (4), where a share is held in depository form, the record of the depository is the *prima facie* evidence of the interest of the beneficial owner.

(5) Punishment for issuing Duplicate Certificate of Shares with intent to Defraud: As per Section 46 (5), if a company with intent to defraud issues a duplicate certificate of shares, the punishment shall be as under:

- the company shall be punishable with fine which shall not be less than five times the face value of the shares involved in the issue of the duplicate certificate but which may extend to ten times the face value of such shares or rupees ten crores whichever is higher; and
- every officer of the company who is in default shall be liable for action under section 447[5].

Physical entitlement to a particular portion of share capital is *prima facie* evidenced by way of a share certificate which has to be:

- distinctively numbered; and

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[4]Refer Rules 5, 6 and 7 of the *Companies (Shares and Debentures) Rules, 2014* in this respect.
[5]The provisions contained in Section 447 which describe 'punishment for fraud' are stated in the earlier Chapter 3 relating to 'Prospectus and Allotment of Securities'.

- issued under common seal[6] of the company or signed by two directors or by a director and the Company Secretary, wherever the company has appointed a Company Secretary.

In case the company is required to issue duplicate certificates, it can do so after following the procedure prescribed in Rule 6 of the *Companies (Shares and Debentures) Rules, 2014*.

The aforesaid requirements are not applicable in case of dematerialised shares or shares held in electronic form with any depository. In such a case, records of the depository will be treated as *prima facie* evidence of the interest of the beneficial owner.

Dematerialisation (in short 'Demat') of Securities: After the depositories started functioning in India, the listed shares are required to be held in electronic form. Even banks and financial institutions insist for demat of securities for creation of charge. Now, **Rule 9A** *(inserted w.e.f. 2-10-2018[7])* of the *Companies (Prospectus and Allotment of Securities) Rules, 2014,* requires every unlisted public company to issue the securities only in dematerialised form and also facilitate dematerialisation of all its existing securities.

According to Rule 9A (3), every holder of securities of an unlisted public company,-

(a) who intends to transfer such securities on or after 2nd October, 2018, shall get such securities dematerialised before the transfer; or

(b) who subscribes to any securities of an unlisted public company (whether by way of private placement or bonus shares or rights offer) on or after 2nd October, 2018 shall ensure that all his existing securities are held in dematerialized form before such subscription.

Rule 9A (11) states that Rule 9A shall not apply to an unlisted public company which is:

(a) a Nidhi;

(b) a Government company; or

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[6]Now it is optional for a company to have a common seal in terms of Proviso *(inserted by the Companies (Amendment) Act, 2015, w.e.f. 29-05-2015)* to Section 22 (2).

[7]Inserted by the *Companies (Prospectus and Allotment of Securities) Third Amendment Rules, 2018, w.e.f. 2-10-2018.*

(c) a wholly owned subsidiary.

It is to be noted that only unlisted public companies (subject to exceptions) are covered by Rule 9A and therefore, it is not necessary for a private limited company to get its securities dematerialised.

At present, there are two depositories available in India *i.e.* NSDL and CDSL. Various depository participants (DPs) are linked to them. Dematerialised securities are held by the investors in their respective accounts with the DP which keeps a track of transfer, transmission, charge creation etc. There are necessary enabling legal enactments to facilitate all such procedures.

It is noteworthy to observe that the share certificates issued by a company are comparable with the currency notes issued by the Central Bank *i.e.* Reserve Bank of India. Therefore, strict penal provisions are in existence against fraudulent activities. In such cases, the wrong-doer company and every officer who is in default are punishable under Section 447[8].

4. VOTING RIGHTS AND VARIATION OF SHAREHOLDERS' RIGHTS [SECTION 47 & 48]

Voting Rights [Section 47[9]]

Section 47 governs the voting rights of the members of a company. The provisions of Section 47 are stated as under:

(i) Voting Rights of Members holding Equity Share Capital: Section 47 (1) states that subject to the provisions of section 43, section 50 (2) and section 188 (1)-

[8]The provisions contained in Section 447 which describe 'punishment for fraud' are stated in the earlier Chapter 3 relating to 'Prospectus and Allotment of Securities'.

[9]Section 47 shall not apply to a Specified IFSC Public Company, where memorandum of association or articles of association of such company provides for it. - (Notification No. GSR 8 (E), dated 4th January, 2017.)

(a) every member of a company limited by shares and holding equity share capital therein, shall have a right to vote on every resolution placed before the company; and

[10](b) his voting right on a poll shall be in proportion to his share in the paid-up equity share capital of the company.

(ii) Voting Rights of Members holding Preference Share Capital: According to Section 47 (2), every member of a company limited by shares who is holding any preference share capital shall, in respect of such capital, have—

- a right to vote only on resolutions placed before the company which directly affect the rights attached to his preference shares, and
- a right to vote on any resolution for the winding up of the company, or for the repayment or reduction of its equity or preference share capital.

and his voting right on a poll shall be in proportion to his share in the paid-up preference share capital of the company.

(iii) Proportion of Voting Rights: According to First Proviso to Section 47 (2), the proportion of the voting rights of equity shareholders to the voting rights of the preference shareholders shall be in the same proportion as the paid-up capital in respect of the equity shares bears to the paid-up capital in respect of the preference shares.

(iv) Consequences when Dividends are not paid to Preference Shareholders: According to Second Proviso to Section 47 (2), where the dividend in respect of a class of preference shares has not been paid for a period of two years or more, then such class of preference shareholders shall have a right to vote on all the resolutions placed before the company.

From the above provisions, it is clear that in case of equity shares other than equity shares with differential voting rights, each shareholder is entitled to vote on any resolution placed before the company *i.e.*, in the Annual General Meeting (AGM) or Extra-ordinary General Meeting (EGM) of the members of the company. The voting right shall be proportionate to the paid-up capital of the class of shares involved.

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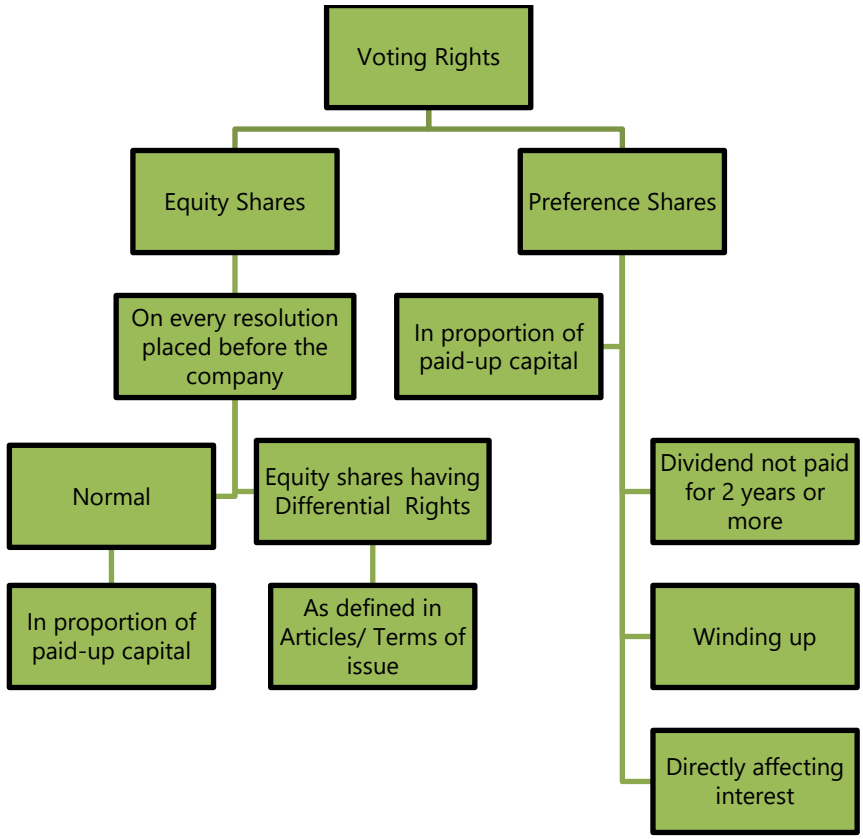
[10]In case of **Nidhis,** Section 47 (1) (b) shall apply, subject to the modification that no member shall exercise voting rights on poll in excess of five per cent, of total voting rights of equity shareholders. (*Notification No. GSR 465 (E), dated 5th June, 2015.)*

Though the preference shareholders have limited voting rights but they shall have a right to vote on all the resolutions placed before the company if the dividend has not been paid to them for a period of two years or more. Similarly, they have a right to vote on any resolution for the winding up of the company or for the repayment or reduction of company's equity or preference share capital.



Exemption to a Private Company[11]- Section 47 shall not apply to a private company, where memorandum or articles of association of the private company so provides. However, the exemption shall be applicable to a private company which has not committed a default in filing its financial statements under section 137 or annual return under section 92 with the Registrar.

Thus, Private company could be more innovative in terms of voting rights if permitted by their Articles of Association.

[11]As per Notification No. GSR 464 (E), dated 5th June, 2015 as amended by Notification No. GSR 583 (E), dated 13th June, 2017.

Variations of Shareholders' Rights [Section 48]

In case share capital of a company is divided into different classes of shares, it may sometimes be necessary for it to amend the rights attached to one or more classes of shares. Section 48 deals with such a situation and regulates the variations of shareholders' rights as under:

(1) Variation in Rights of Shareholders with Consent: According to Section 48 (1), where a share capital of the company is divided into different classes of shares, the rights attached to the shares of any class may be varied with the consent in writing of the holders of not less than three-fourths of the issued shares of that class or by means of a special resolution passed at a separate meeting of the holders of the issued shares of that class,—

(a) if provision with respect to such variation is contained in the memorandum or articles of the company; or

(b) in the absence of any such provision in the memorandum or articles, if such variation is not prohibited by the terms of issue of the shares of that class.

It is provided that if variation by one class of shareholders affects the rights of any other class of shareholders, the consent of three-fourths of such other class of shareholders shall also be obtained and the provisions of this section shall apply to such variation.

(2) No Consent given for Variation: According to Section 48 (2), where the holders of not less than ten per cent of the issued shares of a class did not consent to such variation or vote in favour of the special resolution for the variation, they may apply to the Tribunal to have the variation cancelled, and where any such application is made, the variation shall not have effect unless and until it is confirmed by the Tribunal.

(3) Application to Tribunal: Proviso to Section 48 (2) states that an application under this section shall be made within twenty-one days after the date on which the consent was given or the resolution was passed, as the case may be, and may be made on behalf of the shareholders entitled to make the application by such one or more of their number as they may appoint in writing for the purpose.

(4) Decision of Tribunal: According to Section 48 (3), the decision of the Tribunal on any application under sub-section (2) shall be binding on the shareholders.

(5) Filing of copy of order with Registrar: 48 (4) states that the company shall, within thirty days of the date of the order of the Tribunal, file a copy thereof with the Registrar.

5. CALLS, CALLS-IN-ADVANCE AND INCIDENTAL MATTERS [SECTION 49 TO SECTION 51]

When the shares are partly paid-up, the company issuing them can make calls**,** asking the shareholders to pay the amount 'called up' in respect of such partly paid-up shares.

As per **Section 49**, these calls have to be uniformly made and there should be no differentiation for a given class of shareholders.

As per *Explanation* to Section 49*,* shares of the same nominal value on which different amounts have been paid-up shall not be deemed to fall under the same class (*i.e.* the provision is not applicable in case where different amounts are paid for a same class of shares).

Calls-in-Advance

As per **Section 50**, a company may, if so authorised by its articles, accept from any member, the whole or a part of the amount remaining unpaid on any shares held by him, even if no part of that amount has been called up (*i.e.* if authorised by the articles, a company is permitted to keep advance subscription or call money received in advance).

However, a member of a company limited by shares shall have no voting right in respect of the 'advance amount' paid by him on 'calls' till the amount is duly called up.

According to **Section 51**, the company is permitted to pay dividends in proportion to the amount paid-up on each share, if so authorised by the articles**.**

In other words, advance payment will not lead to increased voting rights but delayed payment of call money could be the reason of decreased voting rights.

Example 2: Moon Star Machineries Limited is authorised by its articles to accept the whole or any part of the amount of remaining unpaid calls from any member even if no part of that amount has been called up by it. 'Anand', a shareholder, deposits in advance the remaining amount due on his partly paid-up shares without any calls being made by the company.

In view of the authorisation given by the Articles, Moon Star Machineries Limited is permitted to accept the advance amount received on unpaid calls from Anand. In other words, this is a valid transaction.

Example 3: Coriander Masale Limited has issued 10,00,000 equity shares of ₹ 10 each on which ₹ 6 per share has been called till allotment and the first and final call of ₹ 4 is yet to be made. Reena holds 10,000 shares on which she has paid whole of ₹ 10 per share. In the upcoming extra-ordinary general meeting of the company she wants to exercise her voting rights as the owner of fully paid-up shares. However, the company cannot permit her as she does not have voting right in respect of the 'advance amount' paid by her in respect of first and final call. The restriction will continue till the amount is duly called up by the company.

6. ISSUE OF SHARES AT A PREMIUM OR DISCOUNT [SECTION 52 TO SECTION 55]

Under the concepts of financial management, fair value of a share may be equal to, less than or more than its face value. If a share is issued to the new investors at a price lower than the fair value then the existing shareholders are likely to make an objection. Also, issuing a share at a value more than or less than the fair value may have adverse consequences under the Income Tax Act or under the Foreign Exchange Management Act (FEMA).

When a company issues shares at a price higher than their face value, the shares are said to be issued at premium and the differential amount is termed as premium.

Example 4: A share having face value of ₹ 10 is issued at a price of ₹ 14. The amount over and above the face value of ₹ 10 is called premium.

Where the issue price is lower than the face value of the shares, such issue of shares is regarded as being issued at discount and the differential amount is known as discount.

Example 5: A share having face value of ₹ 5 is issued at a lower price of ₹ 4. The differential amount of ₹ 1 is known as discount which is being allowed by the company.

There are precautionary provisions covered in **Sections 52 and 53** for both these scenarios (*i.e.* premium or discount) to safeguard the issuer company and its stakeholders.

Application of Premiums received on Issue of Shares [Section 52]

Where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount of the premium received on those shares shall be transferred to a **"securities premium account**". Further, the provisions of the Companies Act, 2013 relating to reduction of share capital (which are very stringent) of a company shall, except as provided in this section, apply as if the securities premium account were the paid-up share capital of the company.

Application of Securities Premium Account: The securities premium account may be applied by the company—

(a) towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares;

(b) in writing off the preliminary expenses of the company;

(c) in writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company;

(d) in providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company; or

(e) for the purchase of its own shares or other securities under section 68.

Prescribed Class of Companies are permitted to apply Securities Premium Account: The securities premium account may be applied by such class of companies, as may be prescribed and whose financial statement comply with the accounting standards prescribed for such class of companies under Section 133:

(a) in paying up unissued equity shares of the company to be issued to members of the company as fully paid bonus shares; or

(b) in writing off the expenses of or the commission paid or discount allowed on any issue of equity shares of the company; or

(c) for the purchase of its own shares or other securities under section 68.

Prohibition on Issue of Shares at Discount [Section 53]

A company is prohibited from issuing shares at a discount if it does not follow the provisions of Section 53.

1. According to Section 53 (1), a company shall not issue shares at a discount, except as provided in Section 54.

Note: Section 54 contains provisions for the issue of 'Sweat Equity Shares'.

2. Section 53 (2) states that any share issued by a company at a discount shall be void.

3. **Exception**: Section 53 (2A) states that notwithstanding anything contained in sub-sections (1) and (2), a company may issue shares at a discount to its creditors when its debt is converted into shares in pursuance of any statutory resolution plan or debt restructuring scheme in accordance with any guidelines or directions or regulations specified by the Reserve Bank of India under the Reserve Bank of India Act, 1934 or the Banking (Regulation) Act, 1949.

4. According to Section 53 (3), where any company fails to comply with the provisions of Section 53, such company and every officer who is in default shall be liable to a penalty which may extend to an amount equal to the amount raised through the issue of shares at a discount or five lakh rupees, whichever is less, and the company shall also be liable to refund all monies received with interest at the rate of twelve per cent per annum from the date of issue of such shares to the persons to whom such shares have been issued.

It is to be noted that the restrictions mentioned in Sections **52 and 53** apply only in respect of issue of shares (either equity or preference shares) but not to the issue of any debt related products like bonds or debentures whose pricing is mostly governed by YTM (yield to maturity) considerations.

Issue of Sweat Equity Shares [Section 54]

Sweat equity shares are issued to keep the employees of a company motivated by making them partner in the growth of the company.

Meaning of 'sweat equity shares': As per **Section 2 (88),** the term 'sweat equity shares' means such equity shares as are issued by a company to its directors or employees at a discount or for consideration, other than cash, for providing their know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

Issue of 'sweat equity shares': Section 54 mentions the provisions which need to be adhered to by a company if it desires to issue sweat equity shares.

Conditions: According to Section 54 (1), a company may issue sweat equity shares of a class of shares already issued, if the following conditions are fulfilled, namely—

(a) the issue is authorised by a special resolution passed by the company;

(b) the resolution specifies the number of shares, the current market price, consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued;

[12](d) where the equity shares of the company are listed on a recognised stock exchange, the sweat equity shares are issued in accordance with the regulations made by the Securities and Exchange Board in this behalf and if they are not so listed, the sweat equity shares are issued in accordance with Rule 8 of the *Companies (Share and Debentures) Rules, 2014*.

Some of the important provisions contained in Rule 8 *of the Companies (Share and Debentures) Rules, 2014,* are stated as under:

Meaning of Employee[13]: ''Employee'' means-

(a) a permanent employee of the company who has been working in India or outside India; or

(b) a director of the company, whether a whole- time director or not; or

(c) an employee or a director as defined in sub-clauses (a) or (b) above of a subsidiary, in India or outside India, or of a holding company of the company;

Meaning of 'Value additions'[14]: The expression 'Value additions' means actual or anticipated economic benefits derived or to be derived by the company from an expert or a professional for providing know-how or making available rights in the nature of intellectual property rights, by such person to whom sweat equity is being issued for which the consideration is not paid or included in the normal remuneration payable under the contract of employment, in the case of an employee.

Validity of Special Resolution: According to Rule 8 (3), the **special resolution** authorising the issue of sweat equity shares shall be valid for making the allotment within a period of not more than twelve months from the date of passing of the special resolution.

Limit on issue of Sweat Equity Shares: According to Rule 8 (4), a company shall not issue sweat equity shares for more than fifteen per cent of the existing paid up equity share capital in a year or shares of the issue value of rupees five crores, whichever is higher.

Provided that the issuance of sweat equity shares in the Company shall not exceed twenty five percent, of the paid up equity capital of the Company at any time.

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[12] *Clause* (*c*) of Section 54 (1) omitted by the Companies (Amendment) Act, 2017, w.e.f. **7-05- 2018.**

[13] *Explanation (i)* to Rule 8 (1).

[14] *Explanation (ii)* to Rule 8 (1).

Provided further that a startup company, as defined in notification number G.S.R. 127(E), dated the 19th February, 2019 issued by the Department for Promotion of Industry and Internal Trade, Ministry of Commerce and Industry, Government of India, may issue sweat equity shares not exceeding fifty percent of its paid up capital upto ten years from the date of its incorporation or registration.

Lock-in Period: Rule 8 (5) states that the sweat equity shares issued to directors or employees shall be locked in/non-transferable for a period of three years from the date of allotment.

Valuation of Sweat Equity Shares: Rule 8 (6) mentions that the sweat equity shares to be issued shall be valued at a price determined by a registered valuer as the fair price giving justification for such valuation.

Valuation of IPR/know-how/value additions to be done by a Registered Valuer: According to Rule 8 (7), the valuation of intellectual property rights or of know how or value additions for which sweat equity shares are to be issued, shall be carried out by a registered valuer, who shall provide a proper report addressed to the Board of directors with justification for such valuation.

Treatment of non-cash consideration: According to Rule 8 (9), where the sweat equity shares are issued for a non-cash consideration on the basis of a valuation report in respect thereof obtained from the registered valuer, such non-cash consideration shall be treated in the following manner in the books of account of the company:

(a) where the non-cash consideration takes the form of a depreciable or amortizable asset, it shall be carried to the balance sheet of the company in accordance with the accounting standards; or

(b) where clause (a) is not applicable, it shall be expensed as provided in the accounting standards.

Disclosure in the Directors' Report: Rule 8 (13) states that the Board of Directors shall, *inter alia*, disclose in the Directors' Report for the year in which such shares are issued, the specified details of issue of sweat equity shares.

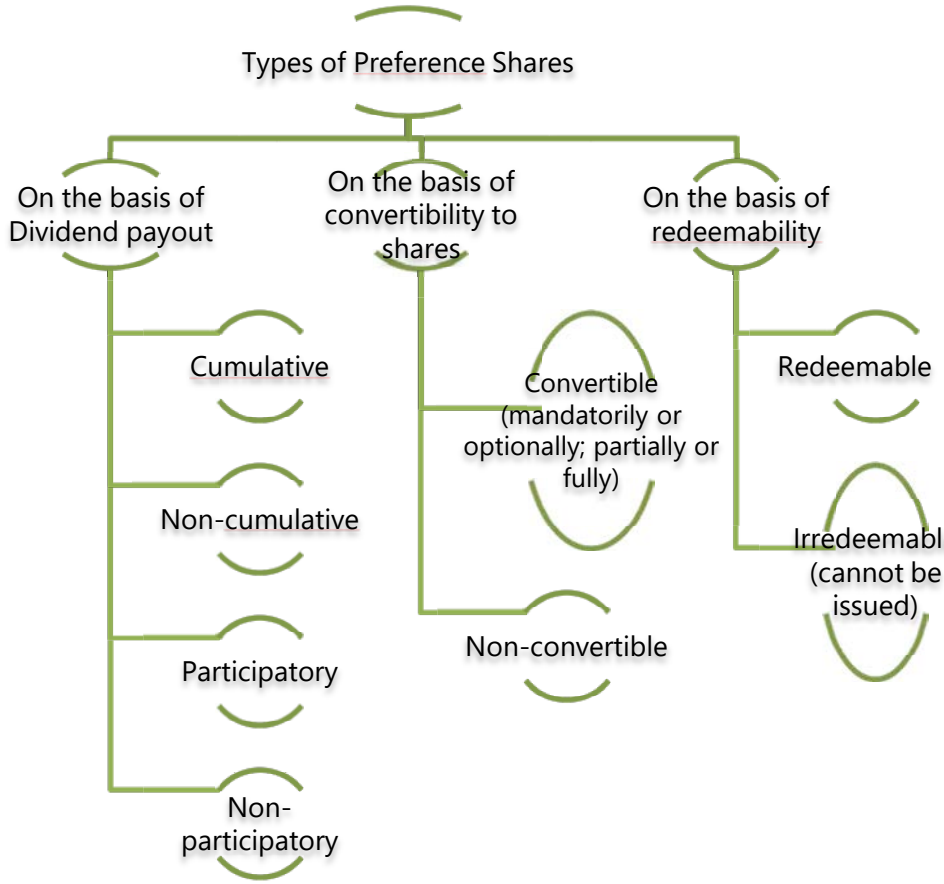
Maintenance of Register: According to Rule 8 (14), the company shall maintain a Register of Sweat Equity Shares in Form No. SH. 3. It shall be maintained at the registered office of the company or such other place as the Board may decide.

Sweat equity shareholders to rank pari passu with other equity shareholders: According to Section 54 (2), the rights, limitations, restrictions and provisions as are

for the time being applicable to equity shares shall be applicable to the sweat equity shares issued under Section 54 and the holders of such shares shall rank *pari passu* with other equity shareholders.

Preference Shares - Issue and Redemption [Section 55]

Following diagram depicts the types of preference shares:



Section 55 contains provisions for regulation of issue and redemption of preference shares. These are stated as under:

(i) Company to issue only Redeemable Preference Shares: A company limited by shares shall not issue any preference shares which are irredeemable.

(ii) Time Period within which Preference Shares are to be redeemed: A company limited by shares may, if so authorised by its articles, issue preference shares which are liable to be redeemed within a period not exceeding twenty years from the date of their issue subject to such conditions as are prescribed in

Rule 9 of the *Companies (Share Capital and Debentures) Rules, 2014*. These conditions are mentioned as under:

Requirement of Special Resolution and Condition of no Default: According to Rule 9 (1), the issue of preference shares has to be authorized by passing a special resolution in the general meeting of the company. Further, at the time of such issue of preference shares, the company should not have subsisting default in the redemption of preference shares issued either before or after the commencement of this Act or in payment of dividend due on any preference shares.

Maintenance of Register: Rule 9 (4) requires that if a company issues preference shares, the Register of Members maintained under Section 88 shall contain the particulars in respect of such preference shareholder(s).

(iii) Exceptional case where period may exceed twenty years[15]: A company may issue preference shares for a period exceeding twenty years (but not exceeding thirty years[16]) for infrastructure projects[17], subject to the [18]redemption of 10% of such preference shares beginning 21st year onwards or earlier, on proportionate basis, at the option of such preferential shareholders.

(iv) Preference Shares to be redeemed out of the Profits only[19]: No such shares shall be redeemed except out of the profits of the company which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares made for the purposes of such redemption.

(v) Only fully paid Preference Shares are to be redeemed[20]: No such shares shall be redeemed unless they are fully paid.

(vi) Transfer to CRR Account[21]: Where such shares are proposed to be redeemed out of the profits of the company, there shall, out of such profits, be transferred, a sum equal to the nominal amount of the shares to be redeemed, to a reserve, to be called the Capital Redemption Reserve (CRR) Account, and the

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[15]As per First Proviso to Section 55 (2).
[16]As per Rule 10 of the *Companies (Share Capital and Debentures) Rules, 2014*.
[17]*Explanation* to Section 55 states that 'Infrastructure Projects' are as specified in Schedule VI to the Companies Act, 2013.
[18]As per Rule 10 of the *Companies (Share Capital and Debentures) Rules, 2014*.
[19]As per Clause (a) of Second Proviso to Section 55 (2).
[20]As per Clause (b) of Second Proviso to Section 55 (2).
[21]As per Clause (c) of Second Proviso to Section 55 (2).

provisions of this Act relating to reduction of share capital of a company shall, except as provided in this section, apply as if the Capital Redemption Reserve Account were paid-up share capital of the company.

Example 6: During the current financial year, the Board of Directors of Vintee Lifestyles Garments Limited is to undertake redemption of 20,000 preference shares of ₹ 100 each at a premium of ₹ 20 per share. It is made out by the Accounts Department that the profits are sufficient to meet the ensuing liability arising out of redemption of preference shares at premium.

In this case, the amount that needs to be transferred to Capital Redemption Reserve (CRR) account, if preference shares are redeemed at a premium out of profits which are otherwise available for dividend, is ₹ 20,00,000 being the sum equal to the nominal amount of the preference shares to be redeemed. There is no need to transfer to CRR account any amount paid towards premium.

(vii) Payment of Premium in case of prescribed Class of Companies[22]: In case of such class of companies, as may be prescribed and whose financial statement comply with the accounting standards prescribed for such class of companies under section 133, the premium, if any, payable on redemption shall be provided for out of the profits of the company, before the shares are redeemed.

The premium, if any, payable on redemption of any preference shares issued on or before the commencement of this Act by any such company shall be provided for out of the profits of the company or out of the company's securities premium account, before such shares are redeemed.

In a case not meeting above criteria, the premium, if any, payable on redemption shall be provided for out of the profits of the company or out of the company's securities premium account, before such shares are redeemed.

(viii) Issue of further Redeemable Preference Shares if a Company is unable to redeem existing preference shares or pay dividend: According to Section 55 (3), where a company is not in a position to redeem any preference shares or to pay dividend, if any, on such shares in accordance with the terms of issue (such shares hereinafter referred to as unredeemed preference shares), it may—

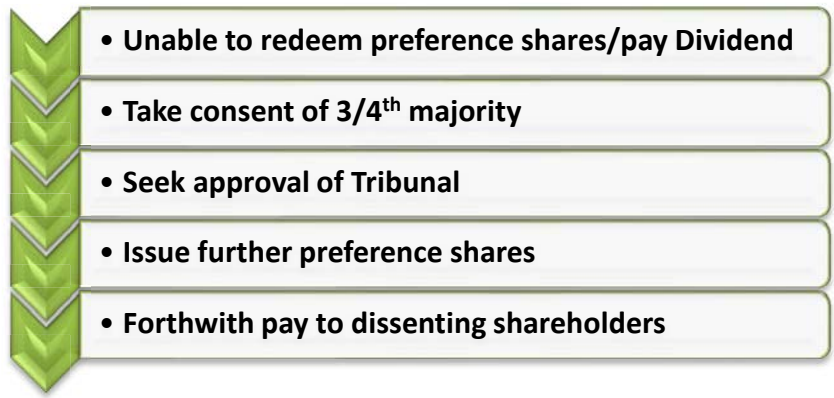
- with the consent of the holders of three-fourths in value of such preference shares, and

[22]As per Clause (d) (i) and (ii) of Second Proviso to Section 55 (2).

➢ with the approval of the Tribunal on a petition made by it in this behalf,

issue further redeemable preference shares equal to the amount due, including the dividend thereon, in respect of the unredeemed preference shares, and on the issue of such further redeemable preference shares, the unredeemed preference shares shall be deemed to have been redeemed.

It is provided that the Tribunal shall, while giving approval under this sub-section, order the redemption forthwith of preference shares held by such persons who have not consented to the issue of further redeemable preference shares.



Note: According to the *Explanation* given, the issue of further redeemable preference shares or the redemption of preference shares under this section shall not be deemed to be an increase or, as the case may be, a reduction, in the share capital of the company.

Utilisation of CRR Account: According to Section 55 (4), the capital redemption reserve account may be applied by the company in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares.

7. TRANSFER AND TRANSMISSION OF SECURITIES AND THE ALLIED PROVISIONS [SECTION 56 TO SECTION 59]

Section 56 deals with the transfer and transmission of securities or interest of a member in the company.

Requirement for Registering the Transfer of Securities: According to Section 56(1), a company shall not register a transfer of securities of the company, or the

interest of a member in the company in the case of a company having no share capital, unless a proper instrument of transfer in the prescribed form[23], duly stamped, dated and executed by or on behalf of the transferor and the transferee *(except where the transfer is between persons both of whose names are entered as holders of beneficial interest in the records of a depository)*, specifying the name, address and occupation, if any, of the transferee, has been delivered to the company by the transferor or the transferee within a period of 60 days from the date of execution, along with the certificate relating to the securities, or if no such certificate is in existence, along with the letter of allotment of securities.

Where Instrument of Transfer lost/not delivered: First proviso to section 56(1) states that where the instrument of transfer has been lost or the instrument of transfer has not been delivered within the prescribed period, the company may register the transfer on such terms as to indemnity as the Board may think fit.

[24]**[Instrument of Transfer not required in case of Bonds issued by a Government Company –** It is provided that the provisions of this sub-section [i.e. section 56(1)], in so far as it requires a proper instrument of transfer, to be duly

[23]As per Rule 11 (1), Form No. SH-4 is to be used, in case securities are held in physical form.
[24] In terms of Notification No. GSR 463 (E), dated 5th June, 2015 as amended by Notification No. GSR 582 (E), dated 13th June, 2017 and Notification No. GSR 802 (E), dated 23rd February, 2018.

stamped and executed by or on behalf of the transferor and by or on behalf of the transferee, shall not apply with respect to bonds issued by a Government company, provided that an intimation by the transferee specifying his name, address and occupation, if any, has been delivered to the company along with the certificate relating to the bond; and if no such certificate is in existence, along with the letter of allotment of the bond.

Further, the provisions of section 56 (1) shall not apply to a Government Company in respect of securities held by nominees of the Government.

Note: The above exceptions are applicable to a Government Company, which has not committed a default in filing its financial statements under section 137 or Annual Return under section 92 with the Registrar.]

Power of Company to Register Transmission of Shares not affected by section 56 (1): According to section 56 (2), the power of company to register shall not be affected by the provision contained in Section 56 (1). Accordingly, the company is empowered to register, if it receives an intimation of transmission of any right to securities by operation of law from any person to whom such right has been transmitted. In other words, there is no need for submission of instrument of transfer in case of transmission of shares.

Procedure for Transfer of partly paid Shares on an application of transferor alone: According to Section 56 (3), where an application is made by the transferor alone and relates to partly paid shares, the transfer shall not be registered, unless the company gives the notice of the application, in such manner as may be prescribed, to the transferee and the transferee gives no objection to the transfer within two weeks from the receipt of notice.

Subscribing the above position, Rule 11 (3) of the *Companies (Share Capital and Debentures) Rules, 2014,* states that a company shall not register a transfer of partly paid shares, unless the company has given a notice in Form No. SH-5 to the transferee and the transferee has given no objection to the transfer within two weeks from the date of receipt of notice.

Example 7: Himanshu has received a notice from Chaitanya Progressive Books Private Limited on 7th August, 2019 intimating that Shefali has submitted a transfer deed duly signed by her for transfer of 500 partly paid shares (₹ 6 paid-up out of Face Value of ₹ 10 per share) in his name. Himanshu as transferee must raise his objection to the proposed transfer of partly paid shares latest by 21st August, 2019.

Time Period for Delivery of certificates: Section 56 (4) states the time period for delivery of certificates. Accordingly, every company shall, unless prohibited by any provision of law or any order of Court, Tribunal or other authority, deliver the certificates of all securities allotted, transferred or transmitted—

Particulars	**Time Period for delivering the Certificates of all Securities allotted, transferred or transmitted**
In the case of subscribers to the memorandum.	Within 2 months from the date of incorporation.
In the case of any allotment of any of its shares by a company.	Within a period of two months from the date of allotment.
In the case of a transfer or transmission of securities.	Within a period of one month from the date of receipt by the company of the instrument of transfer or the intimation of transmission
In the case of any allotment of debenture.	Within a period of six months from the date of allotment.

Securities dealt with in a Depository*:* According to the Proviso to Section 56 (4), where the securities are dealt with in a depository, the company shall intimate the details of allotment of securities to depository immediately on allotment of such securities.[25]

Transfer of Security of the Deceased Person by his Legal Representative: According to Section 56 (5), the transfer of any security or other interest of a deceased person in a company made by his legal representative shall, even if the legal representative is not a holder thereof, be valid as if he had been the holder at the time of the execution of the instrument of transfer.

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[25] In case of Specified IFSC Public or Specified IFSC Private Company, after the proviso to Section 56 (4), the following proviso shall be inserted, namely:-
"Provided further that a Specified IFSC public company/Specified IFSC Private Company shall deliver the certificates of all securities to subscribers after incorporation, allotment, transfer or transmission within a period of sixty days." (*Vide Notification No. GSR 9 (E), dated 4th January, 2017)*

Example 8: Richa Daniel, after having obtained succession certificate, succeeded to 7,000 shares of ₹ 100 each allotted to her late father Alexender Daniel by Speed Software Limited. To pay off the debt of her cousin Stesley, she wants to transfer whole of the 7,000 shares to her on the basis of a duly stamped instrument of transfer which has been signed by her as well as Stesley. Accordingly, she has delivered the required documents to the company for transfer of shares.

In terms of Section 56 (5), the company, on receipt of duly stamped instrument of transfer along with requisite share certificates and succession certificate, shall transfer the shares in favour of Stesley. Thus, even though Richa Daniel, the legal representative of Alexender Daniel, is not a holder of 7,000 shares as per the Register of Members of the company, the transfer effected by her in favour of her cousin Stesley is a valid transfer as if she had been the holder of securities at the time of executing the transfer deed.

Note: As an alternative, Richa Daniel may choose to get herself registered as holder of the 7,000 shares in which case, she will make an application to Speed Software Limited. Such application shall be accompanied with share certificates and succession certificate. There is no need to submit instrument of transfer or transfer deed in such a case of transmission. This is so because transfer deed cannot be signed by the deceased person as transferor.

On receipt of these documents, the company will scrutinize them and if found in order, it shall proceed to enter the name of Richa Daniel in the Register of Members. Consequently, the name of the deceased person *i.e.* Alexender Daniel shall be deleted. Further, new share certificates will be issued in the name of Richa Daniel, the legal representative of Alexender Daniel.

Cases of Transmission: In the following cases, transmission of shares shall take place:

(a) Death: When a shareholder expires, his shares need to be transmitted to his legal representative.

(b) Insolvency: When a shareholder becomes insolvent, his shares are to be transmitted to his Official Receiver.

(c) Lunacy: When a shareholder becomes lunatic, his shares are to be transmitted to his administrator appointed by the Court.

Punishment for Default in compliance with the provisions: As per Section 56 (6), ***where any default is made in complying with the provisions of sub-***

sections (1) to (5), the company and every officer of the company who is in default shall be liable to a penalty of fifty thousand rupees.

Liability of Depository: Section 56 (7) states that where any depository or depository participant, with an intention to defraud a person, has transferred shares, it shall be liable under Section 447[26] along with the liability mentioned under the Depositories Act, 1996.

Forged Transfer: A forged transfer is a 'nullity' and is not legally binding. Forged transfer takes place when a company effects transfer of shares on the basis of an instrument of transfer containing forged signatures of transferor. Is it possible for a transferee of 'forged transfer' to acquire ownership of shares contained in the instrument of transfer? The answer is 'NO'. At the same time, the transferor who is the real owner continues to be the shareholder and accordingly, the company can be forced by him to delete the name of the transferee and to restore his name as owner of shares in the Register of Members.

What will happen if the transferee of 'forged transfer' transfers the shares to another buyer who does not know about the forgery and the company also registers the transfer in the name of new buyer and endorses the share certificates. In fact, the company cannot deny the ownership rights of new genuine buyer but it can also not deny the ownership rights of original shareholder because 'forged transfer' is void *ab-initio* and therefore, the company has to restore his name. While restoring the name of the original shareholder, the company may be asked to compensate the new genuine buyer who exercised good faith in purchasing the shares. As a remedy, the company may get itself indemnified by the first transferee who used the forged instrument of transfer to get the shares transferred in his name.

Note: With the dematerialisation process becoming a necessity in case of unlisted public companies *i.e.* they are required to dematerialise all of their securities as per Rule 9A of the Companies (Prospectus and Allotment of Securities) Rules, 2014, the chances of forgery are very thin or almost negligible. Though private companies are not required to dematerialise their securities but due to the limited number of shareholders, the company can exercise caution and easily detect the forgery, if at all it is going to happen.

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[26]The provisions contained in Section 447 which describe 'punishment for fraud' are stated in the earlier Chapter 3 relating to 'Prospectus and Allotment of Securities'.

Punishment for Personation of Shareholder [Section 57]

Section 57 contains provisions relating to punishment for personation of a shareholder.

If any person deceitfully personates—

- as an owner of any security or interest in a company, or
- as an owner of any share warrant or coupon issued in pursuance of the Companies Act, 2013, and

thereby obtains or attempts to obtain any such security or interest or any such share warrant or coupon, or receives or attempts to receive any money due to any such owner, such person shall be punishable with imprisonment for a term which shall not be less than one year but which may extend to three years and with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

Refusal of Registration and Appeal against Refusal [Section 58]

It is possible that a company may refuse registration of transfer or transmission. According to Section 2 (68) (i), a private company is required to restrict the right to transfer its shares by providing so in its Articles. However, this right to prohibit transfer is not absolute but it should be reasonable so that it is in the interest of the company.

Section 58 contains the procedure which needs to be followed by a company while refusing to register the transfer of securities. It also contains process of filing appeal against such refusal. The provisions of Section 58 are stated as under:

(i) Notice of Refusal to be sent: According to Section 58 (1), if a private company limited by shares refuses to register the transfer of, or the transmission by operation of law of the right to any securities or interest of a member in the company, then the company shall send notice of refusal to the transferor and the transferee or to the person giving intimation of such transmission, within a period of thirty days from the date on which the instrument of transfer, or the intimation of such transmission, was delivered to the company.

(ii) Securities/other interest a Public Company: As per Section 58 (2), the securities or other interest of any member in a public company are freely transferable.

It is provided that any contract or arrangement between two or more persons in respect of transfer of securities shall be enforceable as a contract.

(iii) Appeal to Tribunal against Refusal: According to Section 58 (3), the transferee may appeal to the Tribunal against the refusal within a period of thirty days from the date of receipt of the notice or in case no notice has been sent by the company, within a period of sixty days from the date on which the instrument of transfer or the intimation of transmission, was delivered to the company.

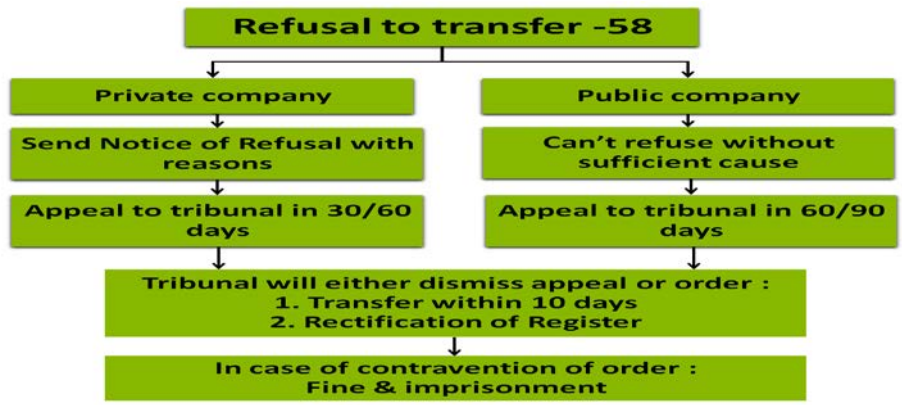
(iv) Appeal to Tribunal against Refusal by a Public Company without sufficient cause: Section 58 (4) states that if a public company without sufficient cause refuses to register the transfer of securities within a period of thirty days from the date on which the instrument of transfer or the intimation of transmission, is delivered to the company, the transferee may, within a period of sixty days of such refusal or where no intimation has been received from the company, within ninety days of the delivery of the instrument of transfer or intimation of transmission, appeal to the Tribunal.

(v) Order of Tribunal: According to Section 58 (5), the Tribunal, while dealing with an appeal may, after hearing the parties, either dismiss the appeal, or by order—

(a) direct that the transfer or transmission shall be registered by the company and the company shall comply with such order within a period of ten days of the receipt of the order; or

(b) direct rectification of the register and also direct the company to pay damages, if any, sustained by any party aggrieved.

(vi) Contravention of the Order of the Tribunal: As per Section 58 (6), if a person contravenes the order of the Tribunal, he shall be punishable with imprisonment for a term not less than one year but may extend to three years and with fine not less than one lakh rupees which may extend to five lakh rupees.



Rectification of Register of Members [Section 59]

Section 59 provides the procedure for the rectification of register of members. These provisions are stated as under:

(i) **Appeal by Aggrieved Person:** According to Section 59 (1), if the name of any person is, without sufficient cause,

- entered in the register of members of a company, or
- after having been entered in the register, is, omitted therefrom, or
- if a default is made, or unnecessary delay takes place in entering in the register, the fact of any person having become or ceased to be a member,

then the person aggrieved, or any member of the company, or the company may appeal in such form as may be prescribed, to the Tribunal, or to a competent court outside India, specified by the Central Government by notification, in respect of foreign members or debenture holders residing outside India, for rectification of the register.

(ii) **Order of the Tribunal:** Section 59 (2) states that the Tribunal may, after hearing the parties to the appeal by order,

- either dismiss the appeal, or
- direct that the transfer or transmission shall be registered by the company within a period of ten days of the receipt of the order, or
- direct rectification of the records of the depository or the register and in the latter case, direct the company to pay damages, if any, sustained by the party aggrieved.

(iii) **Entitlement to Voting Rights:** Section 59 (3) states that the provisions of Section 59 shall not restrict the right of a holder of securities, to transfer such securities. Further, any person acquiring such securities shall be entitled to voting rights unless the voting rights have been suspended by an order of the Tribunal.

(iv) **Transfer of Securities contravenes certain Acts and Direction of Tribunal**: According to Section 59 (4), where the transfer of securities is in contravention of any of the provisions of the Securities Contracts (Regulation) Act, 1956 (SCRA), the Securities and Exchange Board of India Act, 1992 (SEBI) or the Companies Act, 2013 or any other law for the time being in force, the Tribunal may, on an application made by the depository, company, depository participant, the holder of the securities or the Securities and Exchange Board, direct any

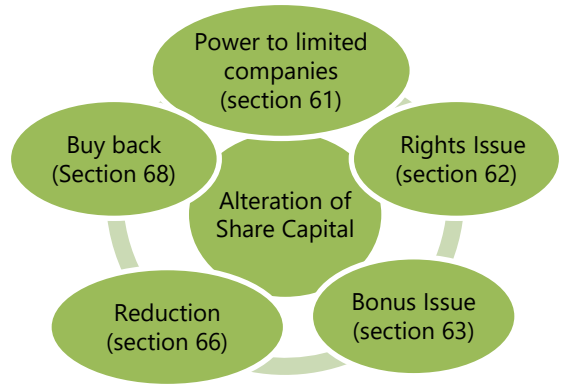
company or a depository to set right the contravention and rectify its register or records concerned.

8. ALTERATION OF SHARE CAPITAL [SECTIONS 61-68]

Before proceeding further, we may look at the following definitions:

Definition of Authorised Capital or Nominal Capital: Section 2(8) defines the term authorised capital or nominal capital to mean such capital as is authorised by the memorandum of a company to be the maximum amount of share capital of the company.

Definition of Called-up Capital: Section 2(15) states that the term called-up capital means such part of the capital, which has been called for payment.



Power of Limited Company to Alter its Share Capital [Section 61]

According to Section 61, a limited company having a share capital is empowered to alter its capital clause of the Memorandum of Association. The provisions are as under:

(1) Section 61 (1) states that a limited company having a share capital may, if so authorised by its articles, alter its memorandum in its general meeting to—

(a) increase its authorised share capital by such amount as it thinks expedient;

(b) consolidate and divide all or any of its share capital into shares of a larger amount than its existing shares,

However, no consolidation and division which results in changes in the voting percentage of shareholders shall take effect unless it is approved by the Tribunal on an application made in the prescribed manner;

(c) convert all or any of its fully paid-up shares into stock, and reconvert that stock into fully paid-up shares of any denomination;

(d) sub-divide its shares, or any of them, into shares of smaller amount than is fixed by the memorandum, so, however, that in the sub-division the proportion between the amount paid and the amount, if any, unpaid on each reduced share shall be the same as it was in the case of the share from which the reduced share is derived.

(e) cancel shares which, at the date of the passing of the resolution in that behalf, have not been taken or agreed to be taken by any person, and diminish the amount of its share capital by the amount of the shares so cancelled.

(2) Section 61 (2) provides that the cancellation of shares shall not be deemed to be a reduction of share capital.

Note: Section 64 states that a company shall, within 30 days of its share capital having been altered in the manner provided in Section 61 (1), give notice to the Registrar in the prescribed form[27] along with an altered memorandum.

Further issue of share capital – Rights Issue; Preferential Allotment [Section 62][28]

A rights issue involves pre-emptive subscription rights to buy additional securities in a company offered to the company's existing security holders. It is a non-dilutive pro rata way to raise capital.

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[27]Form No. SH-7 is to be used as per Rule 15 of the *Companies (Share Capital and Debentures) Rules, 2014*.
Rule 15: Where a company alters its share capital in any manner specified in sub-section (1) of section 61, or an order is passed by the Government increasing the authorized capital of the company in pursuance of sub-section (4) read with sub-section (6) of section 62 or a company redeems any redeemable preference shares or a company not having share capital increases number of its members, the notice of such alteration, increase or redemption shall be filed by the company with the Registrar in Form No. SH.7 along with the fee.

[28]In case of Nidhis, Section 62 shall not apply. While complying with such exception, the Nidhis shall ensure that the interests of their shareholders are protected. *(Notification No. GSR 465 (E), dated 5th June, 2015).*

Example 9: If a company announces '1:10 rights issue', it means an existing shareholder can buy one extra share for every ten shares held by him/her. Usually the price at which the new shares are issued by way of rights issue is less than the prevailing market price of the stock to encourage subscription.

A public company may issue securities through a rights issue or a bonus issue in accordance with the provisions of this Act and in case of a listed company or a company which intends to get its securities listed also with the provisions of the Securities and Exchange Board of India Act, 1992 and the rules and regulations made thereunder as per section 23(1)(c) of the Companies Act, 2013.

A private company may issue securities by way of rights issue or bonus issue in accordance with the provisions of this Act as per the section 23(2)(a).

Section 62 deals with further issue of share capital. The provisions ensure equitable distribution of such shares to the existing shareholders. These are mentioned in the following paragraphs:

(1) Offering of issue of further Shares: According to Section 62 (1), where at any time, a company having a share capital proposes to increase its subscribed capital by the issue of further shares, such shares shall be offered—

[29](a) to persons who, at the date of the offer, are holders of equity shares of the company in proportion, to the paid-up share capital on those shares by sending a letter of offer subject to the following conditions, namely:—

[30](i) the offer shall be made by notice specifying the number of shares offered and limiting a time not being less than fifteen days or such

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[29]Insertion of Proviso in clause (a) of sub-section (1) of Section 62:
"Provided that notwithstanding anything contained in sub-clause (i), in case of a Specified IFSC Public Company, the periods lesser than those specified in the said sub-clause shall apply if ninety per cent of the members have given their consent in writing or in electronic mode." *(Notification No. GSR 8 (E), dated 4th January, 2017)*

[30]In case of private companies**,** Section 62 (1)(a)(i) and Section 62 (2) shall apply with following modification:
In clause (a), in sub-clause (i), the following proviso shall be inserted:
"Provided that that notwithstanding anything contained in this sub-clause and sub-section (2) of Section 62, in case ninety percent of the members of a private company have given their consent in writing or in electronic mode, the periods lesser than those specified in the said sub-clause or sub-section (2), shall apply". *(Notification No. GSR 464 (E), dated 05-06-2015)*.

lesser number of days as may be prescribed and not exceeding thirty days from the date of the offer within which the offer, if not accepted, shall be deemed to have been declined;

(ii) unless the articles of the company otherwise provide, the offer aforesaid shall be deemed to include a right exercisable by the person concerned to renounce the shares offered to him or any of them in favour of any other person; and the notice referred to in clause (i) shall contain a statement of this right;

(iii) after the expiry of the time specified in the notice aforesaid, or on receipt of earlier intimation from the person to whom such notice is given that he declines to accept the shares offered, the Board of Directors may dispose of them in such manner which is not dis-advantageous to the shareholders and the company.

(b) to employees under a scheme of employees' stock option, subject to special resolution[31] passed by company and subject to the conditions as may be prescribed[32]; or

(c) to any persons, if it is authorised by a special resolution, whether or not those persons include the persons referred to in clause (a) or clause (b), either for cash or for a consideration other than cash, if the price of such shares is determined by the valuation report of a registered valuer, subject to the compliance with the applicable provisions of Chapter III and any other conditions as may be prescribed[33].

This clause authorises company to issue shares to persons other than its existing shareholders and to employees under ESOP. However, the process

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[31](a) *In case of private company* - In clause (b) of Sub-section (1) of Section 62 for the words "special resolution", the words "ordinary resolution" shall be substituted. However, this is applicable to a private company which has not defaulted in filing its financial statements under Section 137 or Annual Return under Section 92. (*Notification No. GSR 464 (E), dated 5th June, 2015 as amended by Notification No. GSR 583 (E), dated 13th June, 2017.)*

(b) In case of Specified IFSC Public Company - Clause (b) of Sub- section (1) of section 62: for the words "special resolution" read as "ordinary resolution". - *Notification No. GSR 8 (E), dated 4th January, 2017.*

[32]Refer Rule 12 of the *Companies (Share Capital and Debentures) Rules, 2014*. In case of a listed company, *SEBI (Share Based Employee Benefits) Regulations, 2014* are to be referred.

[33]Refer Rule 13 of the *Companies (Share Capital and Debentures) Rules, 2014*. In case of a listed company, *SEBI (Share Based Employee Benefits) Regulations, 2014* are to be referred.

to issue those shares is provided under section 42 of the Act (Private Placement).

Note: As per Section 2(37), the term 'employees' stock option' means the option given to the directors, officers or employees of a company or of its holding company or subsidiary company or companies, if any, which gives such directors, officers or employees, the benefit or right to purchase, or to subscribe for, the shares of the company at a future date at a pre-determined price.

In case an unlisted company[34] desires to issue shares under ESOP Scheme to its directors, officers or employees, Rule 12 of the *Companies (Shares and Debentures) Rules, 2014* requires certain conditions to be fulfilled. Some of the important provisions are as under:

(i) According to Rule 12 (1), the issue of Employees' Stock Option Scheme has been approved by the shareholders of the company by passing a special resolution.

The term '**Employee'** means:

(a) a permanent employee of the company who has been working in India or outside India; or

(b) a director of the company, whether a whole-time director or not but excluding an independent director; or

(c) an employee as defined in clause (*a*) or (*b*) of a subsidiary, in India or outside India, or of a holding company of the company

but does not include-

(i) an employee who is a promoter or a person belonging to the promoter group; or

(ii) a director who either himself or through his relative or through any body corporate, directly or indirectly, holds more than ten per cent of the outstanding equity shares of the company:

[34]A listed company while issuing shares under ESOP Scheme shall follow the provisions of SEBI (Share Based Employee Benefits) Regulations, 2014.

Provided that in case of a startup company[35], the conditions mentioned in sub-clauses (i) and (ii) shall not apply up to ten years from the date of its incorporation or registration.

(ii) According to Rule 12 (2), the company shall make the specified disclosures in the explanatory statement annexed to the notice for passing of the resolution.

(iii) According to Rule 12 (3), the companies granting option to its employees pursuant to Employees Stock Option Scheme will have the freedom to determine the exercise price in conformity with the applicable accounting policies, if any.

(iv) According to Rule 12 (6):

(a) There shall be a minimum period of one year between the grant of options and vesting of option:

It is provided that in a case where options are granted by a company under its Employees Stock Option Scheme in lieu of options held by the same person under an Employees Stock Option Scheme in another company, which has merged or amalgamated with the first mentioned company, the period during which the options granted by the merging or amalgamating company were held by him shall be adjusted against the minimum vesting period required under this clause;

(b) The company shall have the freedom to specify the lock-in period for the shares issued pursuant to exercise of option.

(c) The Employees shall not have right to receive any dividend or to vote or in any manner enjoy the benefits of a shareholder in respect of option granted to them, till shares are issued on exercise of option.

(v) According to Rule 12 (8):

(a) The option granted to employees shall not be transferable to any other person.

(b) The option granted to the employees shall not be pledged, hypothecated, mortgaged or otherwise encumbered or alienated in any other manner.

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[35]As defined in notification number GSR 127(E), dated 19th February, 2019 issued by the Department for Promotion of Industry and Internal Trade, Ministry of Commerce and Industry, Government of India.

(c) Subject to clause (d), no person other than the employees to whom the option is granted shall be entitled to exercise the option.

(d) In the event of the death of employee while in employment, all the options granted to him till such date shall vest in the legal heirs or nominees of the deceased employee.

(e) In case the employee suffers a permanent incapacity while in employment, all the options granted to him as on the date of permanent incapacitation, shall vest in him on that day.

(f) In the event of resignation or termination of employment, all options not vested in the employee as on that day shall expire. However, the employee can exercise the options granted to him which are vested within the period specified in this behalf, subject to the terms and conditions under the scheme granting such options as approved by the Board.

(2) Dispatch of Notice to the existing Shareholders: Section 62 (2) requires that the notice referred to in sub-clause (i) of clause (a) of sub-section (1) shall be dispatched through registered post or speed post or through electronic mode or courier or any other mode having proof of delivery to all the existing shareholders at least three days before the opening of the issue.

(3) Exception: According to Section 62 (3), Section 62 shall not apply to the increase of the subscribed capital of a company caused by the exercise of an option attached to the debentures issued or loan raised by the company to convert such debentures or loans into shares in the company.

It is provided that the terms of issue of such debentures or loan containing such an option have been approved before the issue of such debentures or the raising of loan by a special resolution passed by the company in general meeting.

(4) Conversion of Debentures/Loan into Shares: According to Section 62 (4), where any debentures have been issued, or loan has been obtained from any Government by a company, and if that Government considers it necessary in the public interest so to do, it may, by order, direct that such debentures or loans or any part thereof shall be converted into shares in the company on such terms and conditions as appear to the Government to be reasonable in the circumstances of the case even if terms of the issue of such debentures or the raising of such loans do not include a term for providing for an option for such conversion.

Term of Conversion not acceptable to the Company: It is provided that where the terms and conditions of such conversion are not acceptable to the company,

it may, within sixty days from the date of communication of such order, appeal to the Tribunal which shall after hearing the company and the Government pass such order as it deems fit.

(5) Consideration of Terms and Conditions of Conversion by the Government: Section 62 (5) requires that in determining the terms and conditions of conversion, the Government shall have due regard to the financial position of the company, the terms of issue of debentures or loans, as the case may be, the rate of interest payable on such debentures or loans and such other matters as it may consider necessary.

(6) If required, Memorandum needs to be Altered to accommodate increased Share Capital: According to Section 62 (6), where the Government has, by an order made under sub-section (4), directed that any debenture or loan or any part thereof shall be converted into shares in a company and where no appeal has been preferred to the Tribunal or where such appeal has been dismissed, the memorandum of such company shall, where such order has the effect of increasing the authorised share capital of the company, stand altered and the authorised share capital of such company shall stand increased by an amount equal to the amount of the value of shares which such debentures or loans or part thereof has been converted into.

Example 10: A company, listed at Bombay Stock Exchange, intends to offer its new shares to the non-members. The existing members of the company consider such offer as invalid in view of the provisions contained in Section 62 (1) (a). However, the company is not prohibited in absolute terms while offering new shares to the non-members. It can do so after fulfilling the conditions given in Section 62 (1) (c). Thus, new shares of a company limited by shares may be issued to non-members under certain circumstances.

Issue of Bonus Shares [Section 63]

Bonus shares are shares issued proportionately by a company to its current shareholders as fully paid-up shares free of cost.

Section 63 prescribes the condition and the manner of issue of fully paid-up bonus shares by a company to its members. The provisions are as under:

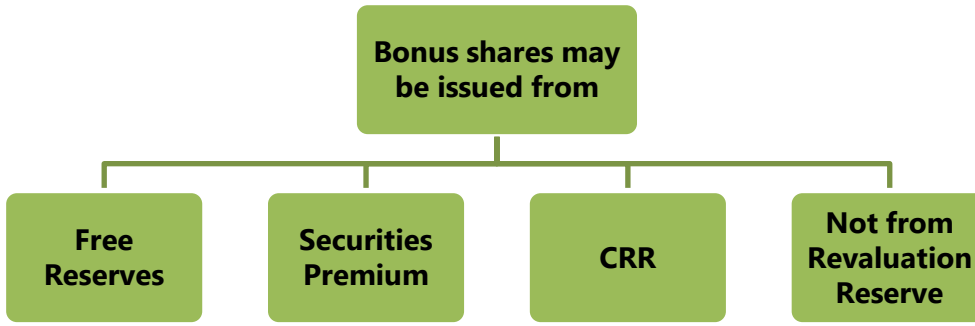
(1) According to Section 63 (1), a company may issue fully paid-up bonus shares to its members, in any manner whatsoever, out of—

(i) its free reserves;

(ii) the securities premium account; or

(iii) the capital redemption reserve account.

However, no issue of bonus shares shall be made by capitalising reserves created by the revaluation of assets. In other words, a company cannot issue bonus shares out of reserves created by the revaluation of assets.



(2) Section 63 (2) states that no company shall capitalise its profits or reserves for the purpose of issuing fully paid-up bonus shares, unless—

(a) it is authorised by its articles;

(b) it has on the recommendation of the Board, been authorised in the general meeting of the company;

(c) it has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it;

(d) it has not defaulted in respect of the payment of statutory dues of the employees, such as, contribution to provident fund, gratuity and bonus;

(e) the partly paid-up shares, if any outstanding on the date of allotment, are made fully paid-up;

(f) it complies with such conditions as prescribed by Rule 14 (given below).

According to Rule 14 of the *Companies (Share capital and debenture) Rules, 2014,* a company which has once announced the decision of its Board recommending a bonus issue, shall not subsequently withdraw the same.

(3) According to Section 63 (3), the bonus shares shall not be issued in lieu of dividend.

It is noteworthy that the fully paid-up bonus shares can only be issued if the articles of the company contain authorisation in this respect. Bonus shares are issued out of

profits which are otherwise available for distribution among the members. Such profits are not distributed among them in cash but the shareholders are allotted further shares in the form of bonus shares. Free reserves, share premium amount and amount lying in capital redemption reserve account can be used for the purpose of issuing fully paid-up bonus shares.

Note: According to the proviso to Section 123(5) of the Companies Act, 2013, it is permissible for a company to capitalise its profits or reserves for the purpose of issuing fully paid up bonus shares or paying up any amount for the time being unpaid on any shares held by the members of the company.

Example 11: XYZ Limited declares bonus shares in the ratio of 1:5. It means an existing shareholder of the company, say Mr. 'R', will get one bonus share free of cost for every five shares already held by him. The larger the holding of any shareholder, the more bonus shares he will get in comparison to others.

Notice to be given to Registrar for alteration of Share Capital [Section 64]

As and when, there is an alteration of share capital, the company concerned shall notify the registrar. The provisions in this respect are contained in Section 64.

(1) Filing of Prescribed Notice: According to Section 64 (1), where–

- a company alters its share capital in any manner specified in section 61 (1),
- an order made by the Government under section 62(4) read with 62(6) has the effect of increasing authorised capital of a company; or
- a company redeems any redeemable preference shares,

the company shall file a notice in the prescribed form[36] with the Registrar within a period of thirty days of such alteration or increase or redemption, as the case may be, along with an altered memorandum.

(2) Default in Filing of Notice: Section 64 (2) states that where any company fails to comply with the provisions of sub-section (1), such company and every officer who is in default shall be liable to a penalty of ***five hundred rupees*** for each day during which such default continues, ***subject to a maximum of five lakh rupees in case of a company and one lakh rupees in case of an officer who is in default*** .

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[36]Form No. SH-7 is to be used as per Rule 15 of the *Companies (Share Capital and Debentures) Rules, 2014*.

Reduction of Share Capital [Section 66]

As a principle of sound financial management, a company is required to keep its capital intact. At times, however, it may become necessary for the company to bring about a reduction in its capital. Accumulated business losses, assets of reduced or doubtful value like unsound investments proving bad or having paid-up capital in excess of the requirements of the company or surplus capital which cannot be employed gainfully, require corrective measures to be taken to keep the financial health of the company in a reasonably well position. Accordingly, the company may find it necessary to reduce its share capital.

Section 66 deals with the reduction of share capital. The provisions are stated as under:

(1) Reduction of Share Capital by Special Resolution to be confirmed by Tribunal: Section 66 (1) provides that subject to confirmation by the Tribunal on an application by the company, a company limited by shares or limited by guarantee and having a share capital may, by a special resolution, reduce the share capital in any manner and in particular, may—

(a) extinguish or reduce the liability on any of its shares in respect of the share capital not paid-up;

Example 12: In respect of a share of ₹ 10, a company has called only ₹ 7 per share and the same has been paid by all the shareholders. The company decides not to call remaining ₹ 3 per share and reduces its shareholders' liability. If done, the company is said to have reduced its share of ₹ 10 to ₹ 7 as fully paid-up share.

(b) either with or without extinguishing or reducing liability on any of its shares,—

(i) cancel any paid-up share capital which is lost or is unrepresented by available assets; or

(ii) pay off any paid-up share capital which is in excess of the wants of the company,

The company shall also alter its memorandum by reducing the amount of its share capital and of its shares accordingly.

Reduction not permitted: Section 66 (1) further Provides that no such reduction shall be made if the company is in arrears in the repayment of any deposits accepted by it, either before or after the commencement of this Act, or the interest payable thereon.

(2) Issue of Notice by the Tribunal : According to Section 66 (2), the Tribunal shall give notice of every application made to it under sub-section (1) to the Central Government[37], Registrar and to the Securities and Exchange Board, in the case of listed companies, and the creditors of the company and shall take into consideration the representations, if any, made to it by that Government, Registrar, the Securities and Exchange Board and the creditors within a period of three months from the date of receipt of the notice.

Where no representation has been received from the Central Government, Registrar, the Securities and Exchange Board or the creditors within the said period, it shall be presumed that they have no objection to the reduction.

(3) Order of Tribunal: According to Section 66 (3), the Tribunal may, if it is satisfied that the debt or claim of every creditor of the company has been discharged or determined or has been secured or his consent is obtained, make an order confirming the reduction of share capital on such terms and conditions as it deems fit.

It is provided that no application for reduction of share capital shall be sanctioned by the Tribunal unless the accounting treatment, proposed by the company for such reduction is in conformity with the accounting standards specified in Section 133 or any other provision of this Act and a certificate to that effect by the company's auditor has been filed with the Tribunal.

(4) Publication of Order of Confirmation of Tribunal: Section 66 (4) states that the order of confirmation of the reduction of share capital by the Tribunal under sub-section (3) shall be published by the company in such manner as the Tribunal may direct.

(5) Delivery of Certified Copy of Order of Tribunal to Registrar: Section 66 (5) requires that the company shall deliver a certified copy of the order of the Tribunal under sub-section (3) and of a minute approved by the Tribunal showing—

(a) the amount of share capital;

(b) the number of shares into which it is to be divided;

(c) the amount of each share; and

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[37]The powers of Central Government stand delegated to Regional Directors. *(Notification No. SO 2938 (E), dated 6th September, 2017.*

(d) the amount, if any, at the date of registration deemed to be paid-up on each share,

to the Registrar within thirty days of the receipt of the copy of the order, who shall register the same and issue a certificate to that effect.

(6) Exemption to Buy-Back: According to Section 66 (6), nothing in this section shall apply to buy-back of its own securities by a company under Section 68.

(7) No Liability of Members: Section 66 (7) states that a member of the company, past or present, shall not be liable to any call or contribution in respect of any share held by him exceeding the amount of difference, if any, between the amount paid on the share, or reduced amount, if any, which is to be deemed to have been paid thereon, as the case may be, and the amount of the share as fixed by the order of reduction.

(8) In case where Creditor is entitled to object but was not included in the list of Creditors: According to Section 66 (8), where the name of any creditor entitled to object to the reduction of share capital under this section is, by reason of his ignorance of the proceedings for reduction or of their nature and effect with respect to his debt or claim, not entered on the list of creditors, and after such reduction, the company commits a default, within the meaning of section 6 of the Insolvency and Bankruptcy Code, 2016, in respect of the amount of his debt or claim-

(a) every person, who was a member of the company on the date of the registration of the order for reduction by the Registrar, shall be liable to contribute to the payment of that debt or claim, an amount not exceeding the amount which he would have been liable to contribute if the company had commenced winding up on the day immediately before the said date; and

(b) if the company is wound up, the Tribunal may, on the application of any such creditor and proof of his ignorance as aforesaid, if it thinks fit, settle a list of persons so liable to contribute, and make and enforce calls and orders on the contributories settled on the list, as if they were ordinary contributories in a winding up.

(9) Rights of Contributories not affected: Section 66 (9) provides that nothing in sub-section (8) shall affect the rights of the contributories among themselves.

(10) Liability of Officers: Section 66 (10) deals with the liability of defaulting officers. Accordingly, if any officer of the company—

(a) knowingly conceals the name of any creditor entitled to object to the reduction;

(b) knowingly misrepresents the nature or amount of the debt or claim of any creditor; or

(c) abets or is privy to any such concealment or misrepresentation as aforesaid,

he shall be liable under Section 447[38].

Restriction on Purchase by Company or giving of Loans by it for Purchase of its Shares [[39]Section 67[40]]

As a fundamental principle, a company cannot buy its own shares because in that case it will involve reduction of share capital affecting the creditors. However, this restriction is not absolute. If the prescribed procedure as laid by Section 67 is followed, the company is permitted to buy its own shares and the prohibition shall not apply. The provisions of Section 67 are mentioned below:

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[38]The provisions contained in Section 447 which describe 'punishment for fraud' are stated in the earlier Chapter 3 relating to 'Prospectus and Allotment of Securities'.

[39]Private companies**:** Section 67 shall not apply to private companies-
(a) in whose share capital no other body corporate has invested any money;
(b) if the borrowings of such a company from banks or financial institutions or any body corporate is less than twice its paid-up share capital or fifty crore rupees, whichever is lower; and
(c) such a company is not in default in repayment of such borrowings subsisting at the time of making transactions under this section. However, the exemption is applicable if the private company has not defaulted in filing its financial statements under Section 137 and Annual Return under Section 92. (*Notification No. GSR 464 (E), dated 5th June, 2015 as amended by Notification No. GSR 583 (E), dated 13th June, 2017).*

[40] Specified IFSC Public Company - Section 67 Shall not apply to a Specified IFSC public company-
(a) in whose share capital no other body corporate has invested any money;
(b) if the borrowings of such company from banks or financial institutions or any body corporate is less than twice of its paid up share capital or fifty crore rupees, whichever is lower; and
(c) such a company is not in default in repayment of such borrowings subsisting at the time of making transactions under this section. (*Notification No. GSR 8 (E), dated 4th January, 2017).*

(1) Reduction according to the applicable Provisions: Section 67(1)[41] lays down that no company limited by shares or by guarantee and having a share capital shall have power to buy its own shares unless the consequent reduction of share capital is effected under the provisions of this Act.

(2) Restriction on giving Loan, Guarantee or provision of Security, etc.: According to Section 67 (2), no public company shall give, whether directly or indirectly and whether by means of a loan, guarantee, the provision of security or otherwise, any financial assistance for the purpose of, or in connection with, a purchase or subscription made or to be made, by any person of or for any shares in the company or in its holding company.

(3) Exceptions: As per Section 66(3), there are, however, certain exceptions where a company may provide the financial assistance, namely:

(a) the lending of money by a banking company in the ordinary course of its business;

(b) the provision is made by a company for lending of money in accordance with any scheme approved by company through special resolution with such requirements as may be prescribed[42], for the purchase of, or subscription for, fully paid up shares in the company or its holding company, if the purchase of, or the subscription for, the shares held by trustees for the benefit of the employees or such shares held by the employee of the company;

(c) the giving of loans by a company to persons in the employment of the company other than its directors or key managerial personnel, for an amount not exceeding their salary or wages for a period of six months with a view to enabling them to purchase or subscribe for fully paid-up shares in the company or its holding company to be held by them by way of beneficial ownership.

However, disclosures in respect of voting rights not exercised directly by the employees in respect of shares to which the scheme relates shall be made in the Board's report in such manner as may be prescribed.

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[41]In case of Nidhis**,** Section 67 (1) shall not apply, when shares are purchased by the company from a member on his ceasing to be a depositor or borrower and it shall not be considered as reduction of capital under Section 66 of the Companies Act, 2013. While complying with such exception, the Nidhis shall ensure that the interests of their shareholders are protected. *(Notification No. GSR 465 (E), dated 5th June, 2015)*

[42]Refer Rule 16 of the *Companies (Share Capital and Debentures) Rules, 2014*.

(4) Redemption of Preference Shares Permitted: According to Section 67 (4), nothing in Section 67 shall affect the right of a company to redeem any preference shares issued under this Act or under any previous company law.

(5) Punishment for Contravention: Section 67 (5) states that if a company contravenes the provisions of this section, the punishment shall be as under:

- **Company:** It shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees;
- **Every officer of the company who is in default:** He shall be punishable with imprisonment for a term which may extend to three years and with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees.

BUY BACK OF SECURITIES [Sections 68-70]

Buy back is the re-acquisition by a company of its own securities. It is a way of returning money to its investors. Section 68 to Section 70 contain provisions for buy back of securities by the issuer company. They are stated as under:

Power of Company to Purchase its Own Securities [Section 68]

Section 68 contains provisions which describe the power a company to purchase its own securities subject to the applicable conditions.

(1) Sources of Funds for Buy-Back of Shares: According to Section 68 (1), a company may purchase its own shares or other specified securities. The purchase should be made out of:

(i) its free reserves; or

(ii) the securities premium account; or

(iii) the proceeds of the issue of any shares or other specified securities.

However, buy-back of any kind of shares or other specified securities cannot be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.

"Specified securities" includes employees' stock option or other securities as may be notified by the Central Government from time to time[43].

[43]As per Explanation I to Section 68.

(2) Conditions for Buy-Back: According to Section 68 (2), the company shall not purchase its own shares or other specified securities unless:

(a) the buy-back is authorised by its articles;

(b) a special resolution authorising the buy-back is passed in general meeting of the company;

Exception: A special resolution is not necessary where:

(i) the buy-back is, ten per cent or less of the total paid-up equity capital and free reserves of the company; and

(ii) such buy-back has been authorised by the Board by means of a resolution passed at its meeting;

(c) the buy-back is 25% or less of the aggregate of paid-up capital and free reserves of the company;

It is provided that the buy-back of equity shares in any financial year shall not exceed 25% of its total paid up equity capital in that financial year.

(d) the ratio of the aggregate debts (secured and unsecured) owed by the company after buy back is not more than twice the paid up capital and its free reserves;

It is provided that the Central Government may prescribe a higher ratio of the debt to capital and free reserves for a class or classes of companies;

The expression "free reserves" includes securities premium account[44].

(e) all the shares or other specified securities for buy-back are fully paid-up;

(f) the buy-back of the shares or other specified securities listed on any recognised stock exchange is in accordance with the regulations made by SEBI in this behalf;

(g) the buy-back in respect of shares or other specified securities other than those specified in Clause (f) is in accordance with rules as may be prescribed. [Sections 68(2)]

Provided that no offer of buy-back, shall be made within a period of one year from the date of the closure of the preceding offer of buy-back, if any.

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[44]As per Explanation II to Section 68.

(3) Procedure before Buy-Back: According to Section 68 (3)[45], the notice of the meeting at which special resolution is proposed to be passed shall be accompanied by an explanatory statement stating -

(a) a full and complete disclosure of all the material facts;

(b) the necessity for the buy-back;

(c) the class of shares or securities intended to be purchased under the buy back;

(d) the amount to be invested under the buy-back; and

(e) the time limit for completion of buy-back.

(4) Time limit for Completion of Buy-Back: Section 68(4) states that every buy-back shall be completed within twelve months from the date of passing the special resolution or a resolution passed by the Board at general meeting authorising the buy-back.

(5) Whose Securities are to be Purchased under 'Buy-Back': According to Section 68 (5), the buy-back under sub-section (1) may be—

(a) from the existing shareholders or security holders on a proportionate basis; or

(b) from the open market; or

(c) by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.

(6) Declaration of Solvency: According to Section 68 (6), where a company has passed a special resolution under clause (b) of sub-section (2) or the Board has passed a resolution under item (ii) of the proviso to clause (b) of sub-section (2) to buy-back its own shares or other securities, it shall, before making such buy-back, file with the Registrar and the SEBI, a declaration of solvency in the form as may be prescribed[46] and verified by an affidavit to the effect that the Board has made a full inquiry into the affairs of the company as a result of which they have formed an opinion that it is capable of meeting its liabilities and will

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[45]Rule 17 (1) of the *Companies (Share Capital and Debentures), Rules, 2014* details out the matters to be included in the 'explanatory statement'.

[46]Form No. SH-9 to be used as per Rule 17 (3) of the *Companies (Share Capital and Debentures), Rules, 2014*.

not be rendered insolvent within a period of one year from the date of declaration of solvency adopted by the Board. The declaration shall be signed by at least two directors of the company, one of whom shall be the managing director, if any;

Provided that no declaration of solvency shall be filed with the SEBI by a company whose shares are not listed on any recognised stock exchange.

(7) Extinguishment of Securities: Section 68 (7) requires that where a company buys back its own securities or other specified securities, it shall extinguish and physically destroy the shares or securities so bought-back within seven days of the last date of completion of buy-back.

(8) Cooling Period: Section 68 (8) casts an obligation that where a company completes a buy-back of its shares or other specified securities under this section, it shall not make further issue of same kind of shares including allotment of further shares under Section 62 (1) (a) or other specified securities within a period of six months except by way of bonus issue or in the discharge of subsisting obligations such as conversion of warrants, stock option schemes, sweat equity or conversion of preference shares or debentures into equity shares.

(9) Register of Buy Back: Section 68 (9) requires that where a company buys-back its shares or other specified securities under this section, it shall maintain a register[47] of the shares or securities so bought, the consideration paid for the shares or securities bought-back, the date of cancellation of shares or securities, the date of extinguishing and physically destroying the shares or securities and such other particulars as may be prescribed.

(10) Filing of Return of Buy-back: According to Section 68 (10), a company shall, after completion of the buy-back under this section, file with the Registrar and the SEBI, a return[48] containing such particulars relating to the buy-back within thirty days of such completion, as may be prescribed.

However, no return shall be filed with the SEBI by a company whose shares are not listed on any recognised stock exchange.

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[47]To be maintained in Form No. SH-10 as per Rule 17 (12)(a) of the *Companies (Share Capital and Debentures), Rules, 2014*.

[48]To be filed in Form No. SH-11 as per Rule 17 (13) of the *Companies (Share Capital and Debentures), Rules, 2014*.

(11) Penalty for Default: Section 68 (11) states that if a company makes default in complying with the provisions of this section or any regulations made by SEBI, for the purposes (f) of sub-section (2), the punishment shall be as under:

- **Company:** It shall be punishable with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees; and
- **Every officer of the company who is in default:** He shall be punishable with fine which shall not be less than one lakh rupees but which may extend to ***three lakh rupees***.

Transfer of certain Sums to Capital Redemption Reserve Account [Section 69]

Section 69 requires certain amount to be transferred to the capital redemption reserve account in case a company buys back its own shares. The provisions are as under:

(1) Amount to be transferred to CRR Account: Section 69 (1) prescribes that where a company purchases its own shares out of free reserves or securities premium account, then a sum equal to the nominal value of the share so purchased shall be transferred to the capital redemption reserve account and details of such transfer shall be disclosed in the balance sheet.

(2) Application of CRR Account: Section 69 (2) states that the capital redemption reserve account may be applied by the company, in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares.

Prohibition for Buy-Back in Certain Circumstances [Section 70]

Section 70 prohibits a company to buy back its own securities in certain circumstances. The provisions are as under:

(1) No company shall directly or indirectly purchase its own shares or other specified securities-

(a) through any subsidiary company including its own subsidiary companies; or

(b) through any investment company or group of investment companies; or

(c) if a default, is made by the company, in repayment of deposits, interest payment thereon, redemption of debentures or preference shares or payment of dividend to any shareholder or repayment of any term loan or interest payable thereon to any financial institutions or banking company;

It is provided that where the default is remedied and a period of three years has lapsed after such default ceased to subsist, such buy-back is not prohibited.

(2) No company shall directly or indirectly purchase its own shares or other specified securities in case such company has not complied with provisions of:

- Section 92 (Annual Report),
- Section 123 (Declaration and Payment of Dividend),
- Section 127 (Punishment for failure to distribute dividends), and
- Section 129 (Financial Statement).

DEBENTURES [SECTION 71]

Before taking up the provisions of Section 71, we may look into the definition of debenture as given below:

Definition of Debenture

As per Section 2(30), debenture includes debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not:

Provided that—

(a) the instruments referred to in Chapter III-D of the Reserve Bank of India Act, 1934; and

(b) such other instrument, as may be prescribed by the Central Government in consultation with the Reserve Bank of India, issued by a company,

shall not be treated as debenture.

Features of Debentures

- A debenture is the smallest unit of a sizeable amount of loan.

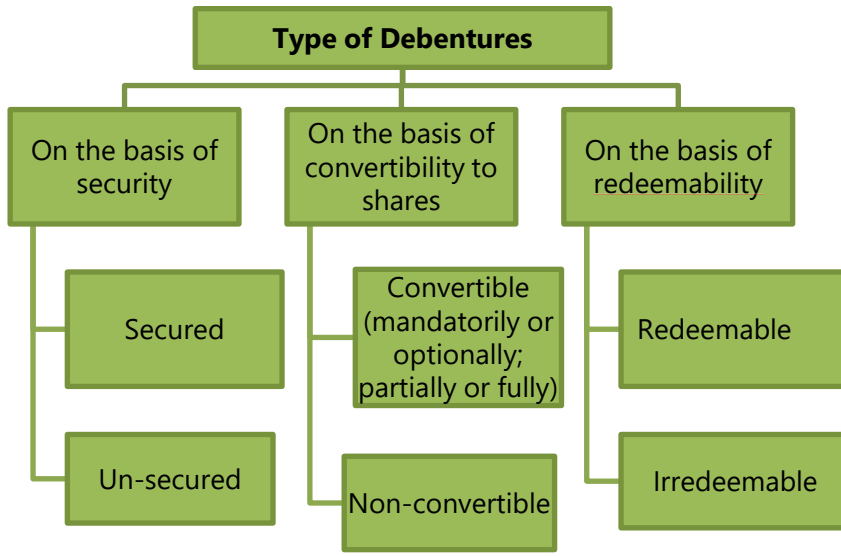
- When debentures are issued, the applicants are given certificates representing the money they have lent to the company.
- A debenture certificate is issued by the company under its common seal, if any, or under the signatures of two directors or a director and the company secretary, if he has been appointed.
- The company pays periodic interest on the amount raised by issuing debentures till they are fully redeemed.
- A debenture is generally pre-fixed with the rate of interest which the company intends to pay.

  Example 13: The name '10% Debentures' indicates that the company shall pay interest at the rate of 10% on the outstanding amount till maturity of such debentures.
- Voting rights are not available in case of debentures since Section 71 (2) clearly states that no company shall issue any debentures carrying any voting rights.
- A debenture is in the nature of movable property which is transferable as per the provisions contained in the Articles of the company issuing the debentures[49].
- A debenture may be secured or unsecured. In case of secured debentures, a charge is created on the assets of the company in favour of debenture trustee.
- As per the terms of the issue of debentures, they may be redeemed (i.e. repaid) at the end of full term or in installments, say yearly or bi-yearly or any other period like in two installments.
- The terms of issue may also provide for conversion of debentures at maturity into equity shares at the option of the debenture holders.
- The debenture certificates are required to be delivered within a period of six months[50] from the date of allotment of debentures, unless the company is prohibited by any provision of law or any order of Court, Tribunal or any other authority.

[49] As per Section 44.
[50] As per Section 56 (4) (d).

Example 14: Sigma Computers Limited desires to borrow ₹ 50,00,000 from the public by issuing 7% Debentures. It is intended that each unit of debenture shall be of ₹ 100. Thus, it can issue 50,000 debentures of ₹ 100 each carrying 7% rate of interest which can be paid at the end of every quarter. If such debentures (secured by a charge on the assets of the company) are issued for six-year duration, the principal amount shall be repaid by the end of sixth year. The terms of issue may even allow repayment of principal amount in equal yearly instalments, in which case a portion of debentures shall be redeemed on yearly basis and the company shall be required to pay interest only on the outstanding amount. The debenture holders may also be given the option of converting their debentures into equity shares at the time of maturity.

Thus, Sigma Computers Limited is able to borrow a large sum of money from different borrowers with the help of debentures and it is not required to approach a single borrower for such a big amount. In other words, 'issue of debentures' is the most convenient way of borrowing large sums of money and at the same time the debenture holders do not exert any influence over the ownership and working of the company unless their interest is jeopardized by certain decisions.



Section 71 provides the manner in which a company may issue debentures. These provisions are stated as under:

(1) Issue of Debentures with an Option to Convert: According to Section 71 (1), a company may issue debentures with an option to convert such debentures into shares, either wholly or partly at the time of redemption.

As a pre-condition, it is provided that the issue of debentures with an option to convert such debentures into shares, wholly or partly, shall be approved by a special resolution passed at a general meeting.

(2) No Voting Rights: Section 71 (2) states that no company shall issue any debentures carrying any **voting rights**.

(3) Issue of Secured Debentures: According to Section 71 (3), secured debentures may be issued by a company subject to such terms and conditions as are prescribed in Rule 18 of the *Companies (Share Capital and Debentures) Rules, 2014*.

According to Rule 18 (1), an issue of secured debentures may be made, provided the date of its redemption shall not exceed ten years from the date of issue.

Provided that the following classes of companies may issue secured debentures for a period exceeding ten years but not exceeding thirty years,

(i) Companies engaged in setting up of infrastructure projects;

(ii) Infrastructure Finance Companies as defined in clause (viia) of sub direction (1) of direction 2 of Non-Banking Financial (Non-deposit accepting or holding) Companies Prudential Norms (Reserve Bank) Directions, 2007;

(iii) Infrastructure Debt Fund Non-Banking Financial Companies' as defined in clause (b) of direction 3 of Infrastructure Debt Fund Non-Banking Financial Companies (Reserve Bank) Directions, 2011;

(iv) Companies permitted by a Ministry or Department of the Central Government or by Reserve Bank of India or by the National Housing Bank or by any other statutory authority to issue debentures for a period exceeding ten years.

Creation of Charge: Such an issue of debentures shall be secured by the creation of a charge on the properties or assets of the company or its subsidiaries or its holding company or its associates companies. Such assets or properties shall be of value which is sufficient for the due repayment of the amount of debentures and interest thereon.

Appointment of Debenture Trustee*:* The company shall appoint a debenture trustee before the issue of prospectus or letter of offer for subscription of its debentures. Further, not later than sixty days after the allotment of the debentures, it shall execute a debenture trust deed[51] to protect the interest of the debenture holders.

[51] Form No. SH-12 is to be used for execution of Trust Deed [refer Rule 18 (5)].

Security: The security for the debentures by way of a charge or mortgage shall be created by the company in favour of the debenture trustee.

(4) Creation of Debenture Redemption Reserve (DRR) Account: Section 71 (4) requires that where debentures are issued by a company under section 71, the company shall create a debenture redemption reserve account out of the profits of the company available for payment of dividend and the amount credited to such account shall not be utilised by the company except for the redemption of debentures. In this respect Rule 18 (7) is relevant which is mentioned below:

Rule 18 (7)[52] specifies that the company shall comply with the requirements with regard to Debenture Redemption Reserve (DRR) and investment or deposit of sum in respect of debentures maturing during the year ending on the 31st day of March of next year, in accordance with the conditions given below:-

(a) Debenture Redemption Reserve shall be created out of profits of the company available for payment of dividend;

(b) The limits with respect to adequacy of Debenture Redemption Reserve and Investment or deposits, as the case may be, shall be as under:-

(i) Debenture Redemption Reserve is not required for debentures issued by All India Financial Institutions regulated by Reserve Bank of India and Banking Companies for both public as well as privately placed debentures;

(ii) For other Financial Institutions within the meaning of clause (72) of section 2 of the Companies Act, 2013, Debenture Redemption Reserve shall be as applicable to Non-Banking Finance Companies registered with Reserve Bank of India.

(iii) For listed companies [other than All India financial Institutions and Banking Companies as specified in sub-clause (i)], Debenture Redemption Reserve is not required in the following cases -

(A) in case of public issue of debentures

A. for NBFCs registered with Reserve Bank of India under section 45-1A of the RBI Act, 1934 and for Housing Finance Companies registered with National Housing Bank;

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[52]*As substituted by the Companies (Share Capital and Debentures) Amendment Rules, 2019, w.e.f. 16-08-2019.*

B. for other listed companies;

(B) in case of privately placed debentures, for companies specified in sub-items A and B,

(iv) for unlisted companies, [other than All India Financial Institutions and Banking Companies as specified in sub-clause (i)] -

(A) for NBFCs registered with RBI under section 45-IA of the Reserve Bank of India Act, 1934 and for Housing Finance Companies registered with National Housing Bank, Debenture Redemption Reserve is not required in case of privately placed debentures.

(B) for other unlisted companies, the adequacy of Debenture Redemption Reserve shall be 10 percent, of the value of the outstanding debentures;

[53](v) In case a company is covered in item item (A) of sub-clause (iii) of clause (b) or item (B) of sub-clause (iv) of clause (b), it shall on or before the 30th day of April in each year, in respect of debentures issued by such a company, invest or deposit, as the case may be, a sum which shall not be less than fifteen percent., of the amount of its debentures maturing during the year, ending on the 31st day of March of the next year in any one or more methods of investments or deposits as provided in sub-clause (vi):

Provided that the amount remaining invested or deposited, as the case may be, shall not any time fall below fifteen percent. of the amount of the debentures maturing during the year ending on 31st day of March of that year.

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[53]With effect from 5-6-2020, sub-clause (v) of Rule 18 (7) (b) stands substituted as under *vide the Companies (Shares and Debentures) Amendment Rules, 2020*:

"(v) In case a company is covered in item (A) of sub-clause (iii) of clause (b) or item (B) of sub-clause (iv) of clause (b), it shall on or before the 30th day of April in each year, in respect of debentures issued by such a company, invest or deposit, as the case may be, a sum which shall not be less than fifteen percent., of the amount of its debentures maturing during the year, ending on the 3 I st day of March of the next year in any one or more methods of investments or deposits as provided in sub-clause (vi):

Provided that the amount remaining invested or deposited, as the case may be, shall not any time fall below fifteen percent. of the amount of the debentures maturing during the year ending on 31st day of March of that year".

(vi) for the purpose of sub clause (v), the methods of deposits or investments, as the case may be, are as follows: -

(A) in deposits with any scheduled bank, free from any charge or lien;

(B) in unencumbered securities of the Central Government or any State Government;

(C) in unencumbered securities mentioned in sub-clause (a) to (d) and (ee) of section 20 of the Indian Trusts Act, 1882;

(D) in unencumbered bonds issued by any other company which is notified under sub-clause (f) of section 20 of the Indian trusts Act, 1882:

Provided that the amount invested or deposited as above shall not be used for any purpose other than for redemption of debentures maturing during the year referred above.

(c) in case of partly convertible debentures, Debenture Redemption Reserve shall be created in respect of non-convertible portion of debenture issue in accordance with this sub-rule,

(d) the amount credited to Debenture Redemption Reserve shall not be utilized by the company except for the purpose of redemption of debentures.

(5) Limitation on the Issue of Prospectus/Offer/Invitation to the public: According to Section 71 (5), no company shall issue a prospectus or make an offer or invitation to the public or to its members exceeding five hundred for the subscription of its debentures, unless the company has, before such issue or offer, appointed one or more debenture trustees and the conditions governing the appointment of such trustees shall be such as are prescribed in Rule 18 (2) of the Companies (Share Capital and Debentures) Rules, 2014.

The provisions of Rule 18 (2) are as under:

The company shall appoint debenture trustees under sub-section (5) of section 71, after complying with the following conditions, namely:—

(a) the names of the debenture trustees shall be stated in letter of offer inviting subscription for debentures and also in all the subsequent notices or other communications sent to the debenture holders;

(b) before the appointment of debenture trustee or trustees, a written consent shall be obtained from such debenture trustee or trustees proposed to be appointed and a statement to that effect shall appear in the letter of offer issued for inviting the subscription of the debentures;

(c) A person shall not be appointed as a debenture trustee, if he—

(i) beneficially holds shares in the company;

(ii) is a promoter, director or key managerial personnel or any other officer or an employee of the company or its holding, subsidiary or associate company;

(iii) is beneficially entitled to moneys which are to be paid by the company otherwise than as remuneration payable to the debenture trustee;

(iv) is indebted to the company, or its subsidiary or its holding or associate company or a subsidiary of such holding company;

(v) has furnished any guarantee in respect of the principal debts secured by the debentures or interest thereon;

(vi) has any pecuniary relationship with the company amounting to two per cent or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year;

(vii) is relative of any promoter or any person who is in the employment of the company as a director or key managerial personnel.

(d) the Board may fill any casual vacancy in the office of the trustee but while any such vacancy continues, the remaining trustee or trustees, if any, may act.

It is provided that where such vacancy is caused by the resignation of the debenture trustee, the vacancy shall only be filled with the written consent of the majority of the debenture holders.

(e) any debenture trustee may be removed from office before the expiry of his term only if it is approved by the holders of not less than three fourth in value of the debentures outstanding, at their meeting.

(6) Debenture Trustee to protect Interest of Debenture Holders: Section 71 (6) requires that a debenture trustee shall take steps to protect the interests of

the debenture-holders and redress their grievances in accordance with such rules as may be prescribed.

In order to protect the interest of debenture holders, Rule 18 (4) provides for the convening of the meeting of debenture-holders. Accordingly, the meeting of all the debenture holders shall be convened by the debenture trustee on:

(a) requisition in writing signed by debenture holders holding at least one-tenth in value of the debentures for the time being outstanding;

(b) the happening of any event, which constitutes a breach, default or which in the opinion of the debenture trustees affects the interest of the debenture holders.

(7) Liability of Debenture Trustee*:* According to Section 71 (7), any provision contained in a trust deed for securing the issue of debentures, or in any contract with the debenture-holders secured by a trust deed, shall be void in so far as it would have the effect of exempting a trustee thereof from, or indemnifying him against, any liability for breach of trust, where he fails to show the degree of care and due diligence required of him as a trustee, having regard to the provisions of the trust deed conferring on him any power, authority or discretion.

It is provided that the liability of the debenture trustee shall be subject to such exemptions as may be agreed upon by a majority of debenture-holders holding not less than three-fourths in value of the total debentures at a meeting held for the purpose.

(8) To pay Interest and Redeem Debentures: Section 71 (8) requires that a company shall pay interest and redeem the debentures in accordance with the terms and conditions of their issue.

(9) Filing of Petition before Tribunal by Debenture Trustee: Section 71 (9) states that where at any time the debenture trustee comes to a conclusion that the assets of the company are insufficient or are likely to become insufficient to discharge the principal amount as and when it becomes due, the debenture trustee may file a petition before the Tribunal and the Tribunal may, after hearing the company and any other person interested in the matter, by order, impose such restrictions on the incurring of any further liabilities by the company as the Tribunal may consider necessary in the interests of the debenture-holders.

(10) Order of Tribunal on Failure to Redeem Debentures/Pay Interest: According to Section 71 (10), where a company fails to redeem the debentures on the date of their maturity or fails to pay interest on the debentures when it is due,

the Tribunal may, on the application of any or all of the debenture-holders, or debenture trustee and, after hearing the parties concerned, direct, by order, the company to redeem the debentures forthwith on payment of principal and interest due thereon.

(11) Specific Performance of the Contract: Section 71 (12) states that a contract with the company to take up and pay for any debentures of the company may be enforced by a decree for specific performance.

(12) Procedure to be prescribed by Central Government[54]: According to Section 71 (13), the Central Government may prescribe the procedure, for securing the issue of debentures, the form of debenture trust deed, the procedure for the debenture-holders to inspect the trust deed and to obtain copies thereof, quantum of debenture redemption reserve required to be created and such other matters.

(13) Limit on Borrowings through Debentures[55]: Before the issue of debentures, the Board of Directors of the company shall obtain approval of the shareholders through special resolution if the borrowings by issuing debentures together with the amount already borrowed exceed the aggregate of company's paid-up share capital, free reserves and securities premium amount. Temporary loans obtained from the company's bankers in the ordinary course of business are not to be included in the borrowings.

(14) Return of Allotment[56]: If a company having share capital makes allotment of any debentures (falls within the definition of 'securities'), it is required to file with the jurisdictional Registrar a Return of Allotment (Form No. PAS-3) within thirty days of such allotment.

SUMMARY

- There are two kinds of long-term capital to run a business viz., owners' capital and lender's capital.
- Each type of capital is denominated by different securities with applicable rights which can be varied by following the legal procedure.

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[54]Refer Rule 18 of *the Companies (Share Capital and Debentures) Rules, 2014.*

[55]As per Section 180 (1) (c) [not applicable to a private company vide Notification No. GSR 464 (E), dated 5-6-2015.]

[56]As per Rule 12 (1) of the *Companies (Prospectus and Allotment of Securities) Rules, 2014*.

- Most of the requirements applicable to a company are to be in accordance with its Articles of Association and Memorandum of Association or with the decisions taken by the shareholders at the general meetings but they must be legally valid as per the provisions of the Companies Act.
- There are mandated provisions relating to the application securities premium amount.
- Companies are not permitted to issue shares at a discount except when such shares are issued as sweat equity.
- No company can issue irredeemable preference shares.
- Only fully paid-up preference shares are eligible for redemption.
- When preference shares are redeemed out of profits, the company is required to create Capital Redemption Reserve Account.
- Capital Redemption Reserve Account may be applied for issuing fully paid bonus shares.
- Power to alter share capital by a limited company having a share capital is envisaged under Section 61.
- Companies can issue rights shares to their existing shareholders in accordance with Section 62.
- Issue of bonus shares is governed by Section 63.
- After following the prescribed legal procedure, a company is permitted to bring about reduction in its share capital.
- A company is restricted to purchase or give loans for purchase of its shares except where buy-back is resorted to in accordance the applicable provisions.
- Buy-back of shares is prohibited under certain circumstances.
- Debenture Redemption Reserve A/c is created to ring fence funds requirement for redemption of Debentures.

TEST YOUR KNOWLEDGE

Question 1

VRS Company Ltd. is holding 45% of total equity shares in SV Company Ltd. The Board of Directors of SV Company Ltd. (incorporated on January 1, 2019) decided to raise the share capital by issuing further equity shares. The Board of Directors resolved not to offer any shares to VRS Company Ltd., on the ground that it was already holding a high percentage of the total number of shares issued by SV Company Ltd. The Articles of Association of SV Company Ltd. provide that the new shares should first be offered to the existing shareholders of the company. On March 1, 2019 SV Company Ltd. offered new equity shares to all the shareholders except VRS Company Ltd.

Referring to the provisions of the Companies Act, 2013 examine the validity of the decision of the Board of Directors of SV Company Ltd. of not offering any further shares to VRS Company Limited.

Answer

The legal issues involved herein are covered under Section 62 (1) of the Companies Act, 2013.

Section 62 (1) (a) of the Companies Act, 2013 provides that if, at any time, a company having a share capital proposes to increase its subscribed capital by issue of further shares, such shares should first be offered to the existing equity shareholders of the company as at the date of the offer, in proportion to the paid-up capital on those shares. Hence, the company cannot ignore a section of the existing shareholders and must offer the shares to the existing equity shareholders in proportion of their holdings.

As per facts of the case, the Articles of SV Company Ltd. provide that the new shares should first be offered to the existing shareholders. However, the company offered new shares to all shareholders excepting VRS Company Ltd., which held a major portion of its equity shares. It is to be noted that under the Companies Act, 2013, SV Company Ltd. did not have any legal authority to do so.

Therefore, in the given case, decision of the Board of Directors of SV Company Ltd. not to offer any further equity shares to VRS Company Ltd. on the ground that VRS Company Ltd. already held a high percentage of shareholding in SV Company Ltd. is not valid. Such a decision violates the provisions of Section 62 (1) (a) as well as Articles of the issuing company.

Question 2

The Directors of Mars Motors India Ltd. desire to alter Capital Clause of the Memorandum of Association of their company. Advise them about the ways in which the said clause may be altered under the provisions of the Companies Act, 2013.

Answer

Alteration of Capital: Under section 61 (1) a limited company having a share capital may, if authorised by its Articles, alter its Memorandum in its general meeting to:

(i) increase its authorized share capital by such amount as it thinks expedient;

(ii) consolidate and divide all or any of its share capital into shares of a larger amount than its existing shares;

However, no consolidation and division which results in changes in the voting percentage of shareholders shall take effect unless it is approved by the Tribunal on an application made in the prescribed manner.

(iii) convert all or any of its paid- up shares into stock and reconvert that stock into fully paid shares of any denomination.

(iv) sub-divide its shares, or any of them, into shares of smaller amount than is fixed by the Memorandum;

(v) cancel shares which, at the date of the passing of the resolution in that behalf, have not been taken or agreed to be taken by any person, and diminish the amount of its share capital by the amount of the shares so cancelled.

Further, under section 64 where a company alters its share capital in any of the above-mentioned ways, the company shall file a notice in the prescribed form with the Registrar within a period of thirty days of such alteration, along with an altered memorandum. The capital clause of memorandum, if authorised by the articles, shall be altered by passing an ordinary resolution as per Section 61 (1) of the Companies Act, 2013.

Question 3

Ramesh, a resident of New Delhi, sent a transfer deed duly signed by him as transferee and his brother Suresh as transferor, for registration of transfer of shares to Ryan Entertainment Private Limited at its Registered Office in Mumbai. He did

not receive the transferred shares certificates even after the expiry of four months from the date of dispatch of transfer deed. He lodged a criminal complaint in the Court at New Delhi. Decide, under the provisions of the Companies Act, 2013, whether the Court at New Delhi is competent to act in the said matter?

Answer

Jurisdiction of Court, now Tribunal under the Companies Act, 2013: According to Section 56 (4) of the Companies Act, 2013 every company, unless prohibited by any provision of law or of any order of court, Tribunal or other authority, shall deliver the certificates of all shares transferred within a period of one month from the date of receipt by the company of the instrument of transfer.

Further, as per Section 56 (6), where any default is made in complying with the provisions of sub-sections (1) to (5), the company and every officer of the company who is in default shall be liable to a penalty of fifty thousand rupees.

In this case, the jurisdiction binding on the company is that of the State in which the registered office of the company is situated *i.e.* Mumbai. Hence, the Court at Delhi is not competent to act in the matter.

Question 4

Due to insufficient profits, Silver Robotics Limited is unable to redeem its existing preference shares amounting to ₹ 10,00,000 (10,000 preference shares of ₹ 100 each) though as per the terms of issue they need to be redeemed within next two months. It did not, however, default in payment of dividend as and when it became due. What is the remedy available to the company in respect of outstanding preference shares as per the Companies Act, 2013?

Answer

According to Section 55(3) of the Companies Act, 2013, where a company is not in a position to redeem any preference shares or to pay dividend, if any, on such shares in accordance with the terms of issue (such shares hereinafter referred to as unredeemed preference shares), it may—

- with the consent of the holders of three-fourths in value of such preference shares, and
- with the approval of the Tribunal on a petition made by it in this behalf,

issue further redeemable preference shares equal to the amount due, including the dividend thereon, in respect of the unredeemed preference shares, and on the

issue of such further redeemable preference shares, the unredeemed preference shares shall be deemed to have been redeemed.

Provided that the Tribunal shall, while giving approval under this sub-section, order the redemption forthwith of preference shares held by such persons who have not consented to the issue of further redeemable preference shares.

In view of the provisions of Section 55 (3), Silver Robotics Limited can initiate steps for the issue of further redeemable preference shares equal to the amount due *i.e.* ₹ 10,00,000. For this purpose, it shall obtain the consent of the holders of three-fourths in value of such preference shares and also seek approval of the Tribunal by making a petition. In case, there are certain preference shareholders who have not accorded their consent for the proposal of issuing further redeemable preference shares, the Tribunal may order the company to redeem forthwith such preference shares. Accordingly, Silver Robotics Limited must be ready with sufficient funds for the redemption of preference shares held by those who have not consented.

On the issue of such further redeemable preference shares by the company, the unredeemed preference shares shall be deemed to have been redeemed.

Question 5

Trisha Data Security Limited was incorporated on 1st August, 2019 with a paid- up share capital of ₹ 200 crores. Within such a small period of about one year in operation, it has earned sizeable profits and has topped the charts for its high employee-friendly environment. The company wants to issue sweat equity to its employees. A close friend of the CEO of the company has told him that the company cannot issue sweat equity shares as minimum 2 years have not elapsed since the time company commenced its business. The CEO of the company has approached you to advise about the essential conditions to be fulfilled before the issue of sweat equity shares especially since their company is just about a year old.

Answer

Sweat equity shares of a class of shares already issued.

According to section 54 of the Companies Act, 2013, a company may issue sweat equity shares of a class of shares already issued, if the following conditions are fulfilled, namely—

(i) the issue is authorised by a special resolution passed by the company;

(ii) the resolution specifies the number of shares, the current market price, consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued;

(iii) where the equity shares of the company are listed on a recognised stock exchange, the sweat equity shares are issued in accordance with the regulations made by the Securities and Exchange Board in this behalf and if they are not so listed, the sweat equity shares are issued in accordance with such rules as prescribed under Rule 8 of the *Companies (Share and Debentures) Rules, 2014,*

The rights, limitations, restrictions and provisions as are for the time being applicable to equity shares shall be applicable to the sweat equity shares issued under Section 54 and the holders of such shares shall rank *pari passu* with other equity shareholders.

Trisha Data Security Limited can issue Sweat equity shares by following the conditions as mentioned above. It does not make a difference that the company is just about a year old because no such minimum time limit of 2 years in operations is specified under Section 54.

Question 6

Walnut Foods Limited has an authorized share capital of 2,00,000 equity shares of ₹ 100 per share and an amount of ₹ 2 crores in its Securities Premium Account as on 31-3-2020. The Board of Directors seeks your advice about the application of securities premium account for its business purposes. Please give your advice.

Answer

Amount lying to the credit of Securities Premium Account is required to be utilised for certain prescribed purposes.

According to section 52 of the Companies Act, 2013, where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount of the premium received on those shares shall be transferred to a "securities premium account" and the provisions of this Act relating to reduction of share capital of a company shall, except as provided in this Section, apply as if the securities premium account were the paid-up share capital of the company.

The securities premium account may be applied by the company—

(a) towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares;

(b) in writing off the preliminary expenses of the company;

(c) in writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company;

(d) in providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company; or

(e) for the purchase of its own shares or other securities under section 68.

The securities premium account may be applied by such class of companies, as may be prescribed and whose financial statement comply with the accounting standards prescribed for such class of companies under section 133,—

(a) in paying up unissued equity shares of the company to be issued to members of the company as fully paid bonus shares; or

(b) in writing off the expenses of or the commission paid or discount allowed on any issue of equity shares of the company; or

(c) for the purchase of its own shares or other securities under section 68.

Keeping the above points in view Walnut Foods Limited should proceed to utilise the amount of Securities Premium Account.

Question 7

OLAF Limited, a subsidiary of PQR Limited, decides to give a loan of ₹ 4,00,000 to its Human Resource Manager Mr. Surya Nayan, who does not fall in the category of Key Managerial Personnel and draws a salary of ₹ 40,000 per month, to buy 500 partly paid-up equity shares of ₹ 1000 each in OLAF Limited. Examine the validity of company's decision under the provisions of the Companies Act, 2013.

Answer

Restrictions on purchase by company or giving of loans by it for purchase of its share: As per section 67 (3) of the Companies Act, 2013 a company is allowed to give a loan to its employees subject to the following limitations:

(a) The employee must not be a director or Key Managerial Personnel;

(b) The amount of such loan shall not exceed an amount equal to six months' salary of the employee.

(c) The loan must be extended for subscribing fully paid-up shares.

In the given instance, Human Resource Manager Mr. Surya Nayan is not a Key Managerial Personnel of the OLAF Limited. Further, he is drawing a salary of ₹ 40,000 per month and wants to avail loan for purchasing 500 partly paid-up equity shares of ₹ 1000 each of OLAF Limited in which he is employed.

Keeping the above facts and legal provisions in view, the decision of OLAF Limited in granting a loan of ₹ 4,00,000 for purchase of its partly paid-up shares to Human Resource Manager is invalid due to the following reasons:

i. The amount of loan is more than 6 months' salary of Mr. Surya Nayan, the HR Manager. It should have been restricted to ₹ 2,40,000 only.

ii. The loan to be given by OLAF Limited to its HR Manager Mr. Surya Nayan is meant for purchase of partly paid shares.

Question 8

Shilpi Developers India Limited owed to Sunil ₹ 10,000. On becoming this debt payable, the company offered Sunil 100 shares of ₹ 100 each in full settlement of the debt. The said shares were allotted to Sunil as fully paid-up in lieu of his debt. Examine the validity of this allotment in the light of the provisions of the Companies Act, 2013

Answer

Under Section 62 (1) (c) of the Companies Act, 2013 where at any time, a company having a share capital proposes to increase its subscribed capital by the issue of further shares, either for cash or for a consideration other than cash, such shares may be offered to any persons, if it is authorised by a special resolution and if the price of such shares is determined by a empowered to allot the shares to Sunil in settlement of its debt to him. This valuation report of a registered valuer, subject to the compliance with the applicable provisions of Chapter III and any other conditions as may be prescribed.

In the present case, Shilpi Developers India Limited's allotment, to be classified as shares issued for consideration other than cash, must be approved by the members by a special resolution. Further, the valuation of the shares must be done by a registered valuer, subject to the compliance with the applicable provisions of Chapter III and any other conditions as may be prescribed.

Question 9

What are the provisions of the Companies Act, 2013 relating to the appointment of 'Debenture Trustee' by a company? Whether the following can be appointed as 'Debenture Trustee':

(i) A shareholder who has no beneficial interest.

(ii) A creditor whom the company owes ₹499 only.

(iii) A person who has given a guarantee for repayment of amount of debentures issued by the company?

Answer

Appointment of Debenture Trustee: Under section 71 (5) of the Companies Act, 2013, no company shall issue a prospectus or make an offer or invitation to the public or to its members exceeding five hundred for the subscription of its debentures, unless the company has, before such issue or offer, appointed one or more debenture trustees and the conditions governing the appointment of such trustees shall be such as may be prescribed.

Rule 18 (2) of the Companies (Share Capital and Debentures) Rules, 2014, framed under the Companies Act for the issue of secured debentures provide that before the appointment of debenture trustee or trustees, a written consent shall be obtained from such debenture trustee or trustees proposed to be appointed and a statement to that effect shall appear in the letter of offer issued for inviting the subscription of the debentures.

Further according to the rules, no person shall be appointed as a debenture trustee, if he-

(i) beneficially holds shares in the company;

(ii) is a promoter, director or key managerial personnel or any other officer or an employee of the company or its holding, subsidiary or associate company;

(iii) is beneficially entitled to moneys which are to be paid by the company otherwise than as remuneration payable to the debenture trustee;

(iv) is indebted to the company, or its subsidiary or its holding or associate company or a subsidiary of such holding company;

(v) has furnished any guarantee in respect of the principal debts secured by the debentures or interest thereon;

(vi) Has any pecuniary relationship with the company amounting to two percent. or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year;

(vii) is a relative of any promoter or any person who is in the employment of the company as a director or key managerial personnel;

Thus, based on the above provisions answers to the given questions are as follows:

(i) A shareholder who has no beneficial interest, can be appointed as a debenture trustee.

(ii) A creditor whom company owes ₹ 499 cannot be appointed as a debenture trustee. The amount owed is immaterial.

(iii) A person who has given guarantee for repayment of principal and interest thereon in respect of debentures also cannot be appointed as a debenture trustee.

Question 10

Mr. Nilesh has transferred 1000 equity shares of Perfect Vision Private Limited to his sister Ms. Mukta. The company did not register the transfer of shares and also did not send a notice of refusal to Mr. Nilesh or Ms. Mukta within the prescribed period. Discuss as per the provisions of the Companies Act, 2013, whether aggrieved party has any right(s) against the company?

Answer

The problem given in the question is governed by Section 58 of the Companies Act, 2013 dealing with the refusal to register transfer and appeal against such refusal.

In the present case, the company has committed the wrongful act of not sending the notice of refusal to register the transfer of shares.

Under section 58 (1), if a private company limited by shares refuses to register the transfer of, or the transmission by operation of law of the right to any securities or interest of a member in the company, then the company shall send notice of refusal

to the transferor and the transferee or to the person giving intimation of such transmission, within a period of thirty days from the date on which the instrument of transfer, or the intimation of such transmission, was delivered to the company.

According to Section 58 (3), the transferee may appeal to the Tribunal against the refusal within a period of thirty days from the date of receipt of the notice or in case no notice has been sent by the company, within a period of sixty days from the date on which the instrument of transfer or the intimation of transmission, was delivered to the company.

In this case, as the company has not sent even a notice of refusal, Ms. Mukta being transferee can file an appeal before the Tribunal within a period of sixty days from the date on which the instrument of transfer was delivered to the company.

Question 11

Shankar Portland Cement Limited is engaged in the manufacture of different types of cements and has got a good brand value. Over the years, it has built a good reputation and its Balance Sheet as at March 31, 2020 showed the following position:

1. *Authorized Share Capital (25,00,000 equity shares of ₹ 10/- each) ₹ 2,50,00,000*
2. *Issued, subscribed and paid-up Share Capital (10,00,000 equity shares of ₹ 10/- each, fully paid-up) ₹ 1,00,00,000*
3. *Free Reserves ₹ 3,00,00,000*

The Board of Directors are proposing to declare a bonus issue of 1 share for every 2 shares held by the existing shareholders. The Board wants to know the conditions and the manner of issuing bonus shares under the provisions of the Companies Act, 2013.

Answer

According to Section 63 of the Companies Act, 2013, a company may issue fully paid-up bonus shares to its members, in any manner whatsoever, out of -

(i) its free reserves;

(ii) the securities premium account; or

(iii) the capital redemption reserve account.

Provided that no issue of bonus shares shall be made by capitalising reserves created by the revaluation of assets.

Conditions for issue of Bonus Shares: No company shall capitalise its profits or reserves for the purpose of issuing fully paid-up bonus shares, unless—

(i) it is authorised by its Articles;

(ii) it has, on the recommendation of the Board, been authorised in the general meeting of the company;

(iii) it has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it;

(iv) it has not defaulted in respect of payment of statutory dues of the employees, such as, contribution to provident fund, gratuity and bonus;

(v) the partly paid-up shares, if any, outstanding on the date of allotment, are made fully paid-up;

(vi) it complies with such conditions as are prescribed by Rule 14 of the Companies (Share Capital and debentures) Rules, 2014 which states that the company which has once announced the decision of its Board recommending a bonus issue, shall not subsequently withdraw the same.

Further, the company has to ensure that the bonus shares shall not be issued in lieu of dividend.

For the issue of bonus shares Shankar Portland Cement Limited will require reserves of ₹ 50,00,000 (*i.e.* half of ₹ 1,00,00,000 being the paid-up share capital), which is readily available with the company. Hence, after following the above conditions relating to the issue of bonus shares, the company may proceed for a bonus issue of 1 share for every 2 shares held by the existing shareholders.

Question 12

State the legal provisions in respect of 'Declaration of Solvency', which an unlisted public company needs to adhere to while taking steps to buy-back its own shares.

Answer

According to Section 68 (6), where an unlisted public company has passed a special resolution under Section 68 (2) (b) or the Board has passed a resolution under item (ii) of the proviso to Section 68 (2) (b) to buy-back its own shares, it shall, before making such buy-back, file with the Registrar a 'Declaration of Solvency' in Form SH-9.

The declaration shall be verified by an affidavit to the effect that the Board has made a full inquiry into the affairs of the company as a result of which they have formed an opinion that it is capable of meeting its liabilities and will not be rendered insolvent within a period of one year from the date of declaration of solvency adopted by the Board. The declaration shall be signed by at least two directors of the company, one of whom shall be the managing director, if any.