



Question 18. What is meant by 'Redemption out of Capital'?

Answer: When debentures are redeemed out of current resources, the working capital of the company are reduced to that extent, and therefore, it is called redemption out of capital.

In other words when debentures are redeemed out of capital and no profits are utilised for redemption, then such redemption is termed as redemption out of capital.

A company cannot redeem its debentures purely out of capital. At least 50% of debentures issued must be redeemed out of profits by creating a 'Debenture Redemption Reserve' and the balance of debentures issued may be redeemed out of profits or out of capital.

According to the Companies Act, 1956 when debentures are to be redeemed an adequate amount of profits is required to be transferred to 'Debenture Redemption Reserve' every year before the redemption begins. It is to be noted that the Companies Act, 1956 does not spell out at to what is the adequate amount.

For this one can refer to SEBI Guidelines which stipulates that an amount equal to 50% of the debentures issue should be transferred to 'Debenture Redemption Reserve' before the redemption begins. There are exceptions in the following cases

- (i) Infrastructure companies (i.e., those companies that are engaged in the business of developing, maintaining and operating infrastructure facilities)
- (ii) A company that issues debentures with a maturity up to 18 months.
- (iii) In case of Convertible debentures and convertible portion of partly convertible debentures

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