

# SHARE CAPITAL AND DEBENTURES



## LEARNING OUTCOMES

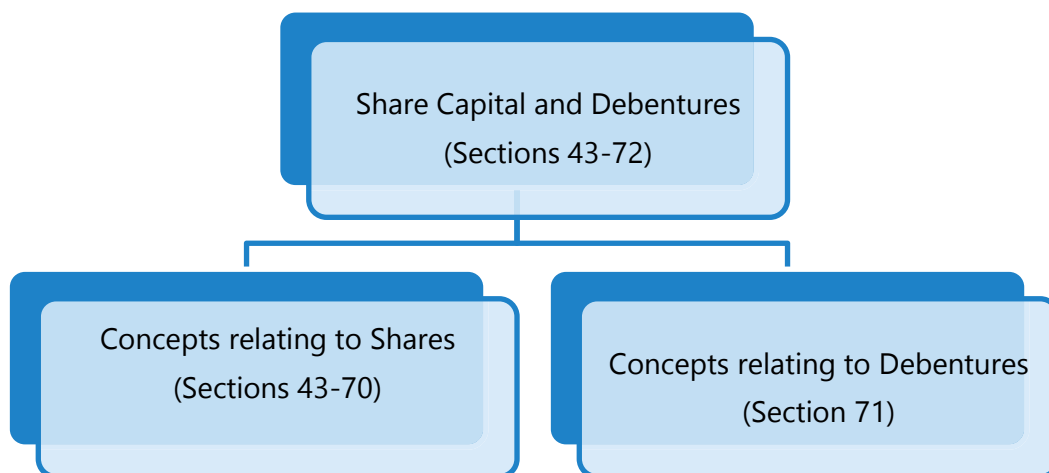
**At the end of this chapter, you will be able to:**

- ◆ 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

This chapter explains the provisions contained in Chapter IV (comprising Section 43 to 72) of the Companies Act 2013 (hereinafter referred to as the Act or this Act) regarding the '**Share Capital and Debentures**', along with relevant procedural aspects explained in the *Companies (Share Capital and Debentures) Rules, 2014*.



### 1. INTRODUCTION

<b>Chapter IV</b>	<b>Consists of sections 43 to 72 as well as the Companies (Share Capital and Debentures) Rules, 2014.</b>
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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

### WHAT ARE SHARE AND STOCK?

#### Share – Definition & Description

Section 2(84) of the Act defines **share** as a **share in the share capital** of a company and **includes stock**.

Capital of a company is termed as share capital, which is divided into units; having a certain face value. Each such unit is termed as **share**.

#### **New London & Brazilian Bank v. Brockle Bank<sup>1</sup>**

A share is not a sum of money..., but **is an interest** measured in a sum of money, and made up of **various rights**, contained in the **contract**, including the right to a sum of money of a more or less amount.

Around two decade later, **J. Farwell** in landmark case of **Borland's Trustee v Steel Brothers & Co Ltd<sup>2</sup>** place his trust in the opinion stated above, and observe that share is the interest of a shareholder in the company measured by a sum of money, for the purpose of liability in the first place and of interest in the second, and also consists of a series of mutual covenants entered into by all the shareholders inter se in accordance with the provisions of the Companies Act and the Articles of Association.

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<sup>1</sup> (1882) 21 Ch D 302 (F)

<sup>2</sup> (1901) 1 Ch 279

**Example 1** - Sun Bakers Limited has authorised share capital of ₹ 50.00 lakh. 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 lakh 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.

**Note:** Company limited by share or those which having share capital has to quote in their memorandum - The share capital of the capital is \_ \_ \_ \_ rupees, divided into \_ \_ \_ \_ shares of \_ \_ rupees each.

### Stock - Description

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 more simple words we can say that 'stock' is a collection or **bundle of fully paid-up shares**.

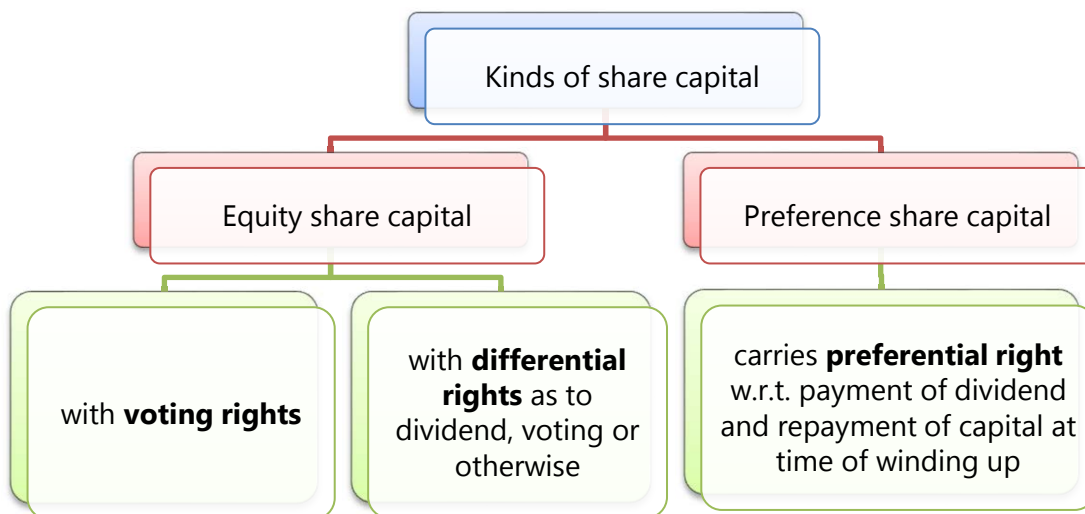
Section 61 (1) (c) of the Act, empower a limited company having a share capital to **convert** all or any of its **fully paid-up shares** into stock, and **reconvert** that stock into fully paid-up shares of any denomination.

#### **Students are advised to take note of - What make stock different?**

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.

### KINDS OF SHARE CAPITAL [SECTION 43]

Broadly, there are two kinds of share capital of a company limited by shares; **Equity share capital** and **Preference share capital**. Equity Share capital can be further segregated into two categories based upon rights. Following diagram depicts kinds of share capital;



### Preference Share Capital [explanation II to section 43]

**Preference share capital** is that part of issued share capital of any company limited by shares which carries preferential right in respect to;

- a. **Payment of dividend**, may be absolute amount or at fixed rate (which may either be free of or subject to income-tax); and
- b. **Repayment of capital**, in the case of **winding up or repayment of capital**. This preference exists only **up to amount paid up or deemed to have been paid up** on the shares, unless there is an agreement in contrary to this.

**Example 2** – Ind-swift Pharma Labs Limited and Panacea Biotech Limited issued preference share.

Ind-swift Pharma provides that the preferential dividend may be a **fixed amount** say ₹ 5,00,000 in one year, payable to preference shareholders before anything is paid to the ordinary shareholders.

Whereas the Panacea Biotech provides that the amount payable as preferential dividend may be calculated at a **fixed rate @ 8 percent of the nominal value** of each share.

**Note:**

1. 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.

2. Preference shareholders **may also participate** in equity pool post the preferential entitlements.

But to find out their rights of participation we must look within the four corners of the **articles of association** and the **terms of the issue**.

If the right to participate in the surplus is not specified in the terms of the issue, preference shares are presumed to be not participating. This was affirmed by the House of Lords in *Scottish Insurance Corpn Ltd vs. Wilsons & Clyde Coal Co Ltd*<sup>3</sup>

3. Preference shares are always **presumed to be cumulative** and the accumulation of dividend can be excluded only by a clear provision in the articles of association<sup>4</sup>

**Illustration – Q&A**

*Can a company have only preference share capital?*

**Answer** – It may be noted that while a company may have only equity share capital but it cannot have only preference share capital. This is because preference shareholders have certain 'preferential rights' over the equity shareholders.

Thus, in the absence of equity share capital, there cannot be preferential share capital<sup>5</sup>

**Equity Share Capital [Section 43(a) read with explanation I to section 43]**

Shares capital which are not preference shares capital are termed as **equity shares capital**. Equity share capital are further classified as;

- a. Equity share with **voting right (Plain vanilla**, because equitable/same voting rights) or
- b. Equity share with **differential rights** with respect to dividend or voting rights or otherwise in accordance with Rule 4 of the *Companies (Share capital and Debenture) Rules, 2014*.

<sup>3</sup> 1949 AC 462 HL

<sup>4</sup> *Staples v Eastman Photographic Materials Co* (1896)

<sup>5</sup> *Bihar State Financial Corporation vs. CIT Bihar* (1976)

Equity shares are often referred as to ordinary share and sometime as common share

**Equity Shares with Differential Rights [Rule 4 of the *Companies (Share capital and Debenture) Rules, 2014*]**

**I. Conditions to issue shares with differential rights**

As per **sub-rule 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**:

- a. The articles of association of the company authorizes the issue of these shares.
- b. Approval of the shareholders is obtained by passing of **ordinary resolution** at the general meeting. A listed public company is required to pass the **resolution through postal ballot**
- c. The voting power in respect of shares with differential rights of the company shall not exceed **Seventy Four**<sup>6</sup> percent of total voting power at any point of time
- d. The company has not defaulted in **filing annual accounts** and **annual returns** for the **3 financial years preceding** the year in which it was decided to issue such shares
- e. The company **has not defaulted** in the payment of declared dividend, interest, or coupon; redemption of preference shares or debenture; or repayment of matured deposits.
- f. The company **has not defaulted** in the
  1. Payment of dividend on preference shares, or
  2. Payment of interest or Repayment of any term loan from a Public Financial Institution (PFI) or State-level Financial Institution (SFI) or Scheduled Bank.
  3. Repayment of any term loan from a PFI or SFI or Scheduled Bank.
  4. Statutory dues relating to its employees
  5. Crediting the amount in Investor Education and Protection Fund

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<sup>6</sup> W.e.f. 16<sup>th</sup> August 2019 through G.S.R. 574(E) (Note - Earlier limit was 26%)



**Note:**

A company may issue equity shares with differential rights upon **expiry of five years** from the **end of the financial year** in which **default** mentioned in point **f** stated above, was **made good**<sup>7</sup>

- g.** the company **has not been penalized** by Court or Tribunal during the **last three years** of any offence under
1. Reserve Bank of India Act, 1934<sup>8</sup>,
  2. Securities and Exchange Board of India Act, 1992<sup>9</sup>,
  3. Securities Contracts Regulation Act, 1956<sup>10</sup>,
  4. Foreign Exchange Management Act, 1999<sup>11</sup> or
  5. Any other special Act, under which such companies being regulated by sectoral regulators.

**Note:**

1. Equity shares with differential rights issued by any company under the provisions of the Companies Act, 1956<sup>12</sup> and the rules made thereunder, shall continue to be regulated under such provisions and rules.<sup>13</sup>
2. Here it is also worth noting that; before the amendment made in year 2000, to the Companies Act 1956<sup>14</sup>, the shares with differential voting rights were not permitted to be issued. Though such differential voting rights existed prior to the enactment of the Companies Act 1956<sup>15</sup>.

**II. Contents of Explanatory statement (annexed to notice)**

**Sub-Rule 2** provides the explanatory statement annexed to the notice of the general meeting or of a postal ballot shall contains various matters like **particulars**

<sup>7</sup> Inserted w.e.f. 19<sup>th</sup> July 2016 though G.S.R. 704(E) - Companies (Share Capital and Debentures) Third Amendment Rules, 2016

<sup>8</sup> Act 2 of 1934

<sup>9</sup> Act 15 of 1992

<sup>10</sup> Act 42 of 1956

<sup>11</sup> Act 42 of 1999

<sup>12</sup> Act 1 of 1956

<sup>13</sup> W.e.f 18<sup>th</sup> June 2014, inserted though G.S.R. 413.(E). - Companies (Share Capital and Debentures) Amendment Rules, 2014 after Rule 4(6).

<sup>14</sup> *Supra* note 15

<sup>15</sup> *ibid*

**of the issue** including its size, **details of differential rights**, etc.

### **III. Prohibition on Conversion**

**Sub-Rule 3** prohibit the conversion of 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**

**Sub-Rule 4** requires, the Board of Directors to 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**

**Sub-rule 5** states that subject to the differential rights, 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.

### **VI. Particulars of shares to be maintained in the register of members**

**Sub-rule 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.

#### **Section 43 shall not apply to:**

1. Specified IFSC Public Company, where memorandum of association or articles of association of such company provides for it.<sup>16</sup>
2. Private company, where memorandum or articles of association of the private company so provides; however, this exemption shall be available to only that 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.<sup>17</sup>

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<sup>16</sup> GSR 8 (E), dated 4th January, 2017

<sup>17</sup> GSR 464 (E), dated 5th June, 2015 as amended by GSR 583 (E), dated 13<sup>th</sup> June, 2017



### 3. CERTIFICATE OF SHARES [SECTION 46]

#### PRIMA FACIE EVIDENCE OF TITLE

##### Shares Issued and held in physical form

**As per sub-section 1**, a **certificate** specifying the shares held by any person, shall be ***prima facie* evidence of the title** of the person to such shares if issued;

- a. Under the common seal if any of the company **or**
- b. Signed by two directors **or**
- c. Signed by a director and the Company Secretary, wherever the company has appointed a Company Secretary

#### Note:

1. Since *w.e.f. 29-05-2015* though Companies Amendment Act 2015, requirement to have common seal is optional for companies, hence physical share certificate issued under sign of two director or of one director along with company secretary is valid.
2. If the composition of the Board permits of it, at least one of the aforesaid two directors shall be a person other than the managing or whole-time director
3. A director shall be deemed to have signed the share certificate if his signature is printed thereon as a facsimile signature by means of any machine, equipment or other mechanical means such as engraving in metal or lithography, or digitally signed, but not by means of a rubber stamp, provided that the director shall be personally responsible for permitting the affixation of his signature thus and the safe custody of any machine, equipment or other material used for the purpose.

##### Shares held in Depository Form

**As per sub-section 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.

**Students are advised to take note:**

Requirement regarding securities issued in Dematerialised form, can be referred in Rule 9 and Rule 9A of the *Companies (Prospectus and Allotment of Securities) Rules, 2014*.

Rule 9A was inserted by the *Companies (Prospectus and Allotment of Securities) Third Amendment Rules, 2018*, w.e.f. 2-10-2018 and requires every unlisted public company to issue the securities only in dematerialised form and also facilitate dematerialisation of all its existing securities.

**ISSUE OF RENEWED/DUPPLICATE SHARE CERTIFICATE [SUB-SECTION 2 READ WITH RULE 6 OF THE COMPANIES (SHARES AND DEBENTURES) RULES, 2014]****Issue of renewed certificate**

A case wherein originally issued share certificate has been defaced, mutilated or torn, a renewed share certificate in replacement shall be issued, in lieu of surrender of such original certificate, to the company.

**Note:**

1. A company may replace all the existing certificates by new certificates upon sub-division or consolidation of shares or merger or demerger or any reconstitution without requiring old certificates to be surrendered
2. On renewed certificate it shall be stated that it is "Issued in lieu of share certificate No..... sub-divided/replaced/on consolidation"
3. Company may charge such a fee as board may think fit, but not exceeding ₹ 50 per certificate; and no fee shall be payable pursuant to scheme of arrangement sanctioned by the High Court or Central Government.

**Issue of duplicate certificate**

A case wherein share certificate originally issue has been lost or destroyed, a share certificate in duplicate may be issued if board is consented for the same based upon evidences produced.

**Students are advised to take note;**

1. Company may charge fees as the Board thinks fit, not exceeding rupees fifty per certificate
2. On the face of duplicate certificate, it shall be stated prominently that it is "duplicate issued in lieu of share certificate No....." and the word "duplicate" shall be stamped or printed prominently
3. In case unlisted companies, the duplicate share certificates shall be issued within a period of three months and in case of listed companies such certificate shall be issued within fifteen days, from the date of submission of complete documents with the company respectively.

**Record of renewed and duplicate certificate to be maintained**

Particulars of every renewed and duplicate share certificates maintained in Form SH 2 with cross reference to register of members, in shape of register.

Such register shall be kept at **registered officer or any other place where register of members in custody** of company secretary or such other person as may be authorised by the Board.

All entries made in such register shall be **authenticated by the company secretary** or such other person as may be authorised by the Board.

**MANNER OF ISSUE OF CERTIFICATES/DUPPLICATE CERTIFICATES**

**Sub-section 3** overrule the articles of a company, and say the issue of a certificate of shares or the duplicate thereof, the particulars to be entered in the register of members and other matters shall be in manner and form as prescribed in rule 5, 6, and 7 of the *Companies (Shares and Debentures) Rules, 2014*.

**Rule 5 of the *Companies (Shares and Debentures) Rules, 2014* applies, where shares are not in demat form**

**Share certificate is in vogue** in case of shares which are **held in the physical form**, not in the demat form (under the depository mode). Hence provisions contained in *rule 5* of the *Companies (Shares and Debentures) Rules, 2014* pertaining to share certificate applicable where shares are not in demat form.

### Pre-requisites for issue of share certificate

Share Certificate shall be issued on **surrender of letter of allotment** or fractional coupons of requisite value (save in cases of issues against letters of acceptance or of renunciation, or in cases of issue of bonus shares); in pursuance of a **resolution passed by the Board**.

### Form of share certificate

Certificate of share shall be in Form SH 1 or as near thereto as possible and shall specify;

- a. The name(s) of the person(s) in whose favor the certificate is issued,
- b. The shares to which it relates and
- c. The amount paid-up thereon.

### Recording of particulars stated in share certificate

The particulars of every share certificate issued in accordance with sub-rule (1) shall be entered in the Register of Members maintained in accordance with the provisions of section 88 along with the name(s) of person(s) to whom it has been issued, indicating the date of issue.

### Maintenance of share certificate forms and related books and documents (Rule 7 of the Companies (Shares and Debentures) Rules, 2014)

All blank forms to be used for issue of share certificates shall be printed and the printing shall be done only on the authority of a resolution of the Board and these shall be consecutively machine-numbered. Such forms shall be kept in the custody of the secretary or such other person as the Board may authorise for the purpose.

All books pertain to record of share certificates shall be preserved in good order not less than thirty years and in case of disputed cases, shall be preserved permanently.

All certificates surrendered to a company shall immediately be defaced by stamping or printing the word "cancelled" in bold letters and may be destroyed after the expiry of three years from the date on which they are surrendered, under the authority of a resolution of the Board and in the presence of a person duly appointed by the Board in this behalf.

**Note:**

1. Share Certificate is not a negotiable instrument.
2. Company shall issue only one share certificate in all those cases where shares are held by more than one person jointly with others and delivery of share certificate to any one of them will amount to delivery to all of them.

**PUNISHMENT FOR ISSUING DUPLICATE CERTIFICATE OF SHARES WITH INTENT TO DEFRAUD [Sub-section 5]**

If a company with intent to defraud issues a duplicate certificate of shares, the punishment shall be as specified in table;

Liabe	Minimum Fine	Maximum Fine
Company	Five times the face value of the shares involved	Higher of: Ten times the face value of such shares <b>or</b> Rupees ten crores
<b>And</b>		
Every officer of the company who is in default	Liable for action under section 447 <b>Note</b> – Provisions of Section 447 already explained as separate topic under chapter 3 of this module.	

**Example 3** – It is observed that Golden Apple Transport Limited issued share certificates in duplicate with intend to defraud. The total shares in regard to which such certificates are issued are nearly 12,00,000. Face value of each share is ₹ 10. The maximum fine that can be imposed on company shall be ₹ 12,00,00,000.



## 4. VOTING RIGHTS [SECTION 47]

### VOTING RIGHTS OF MEMBERS HOLDING EQUITY SHARE CAPITAL [SUB-SECTION 1]

Subject to the provisions of section 43, section 50 (2) and section 188 (1)

- 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**

- b. His voting right on a poll shall be **in proportion to his share in the paid-up equity share capital** of the company. But in case of **Nidhi Company**, no member shall exercise voting rights on poll in **excess of five per cent**, of total voting rights of equity shareholders.<sup>18</sup>

**Note:**

1. As per section 2(93) Voting right means the right of a member of a company to vote in any meeting of the company or by means of postal ballot.
2. Section 106 specify provisions regarding restriction on voting rights.
3. Section 43 has overriding effect on section 47, hence holders of equity share capital with differential rights will exercise voting right as per clauses of article of association or terms of issue; rather on proportional basis.

### **VOTING RIGHTS OF MEMBERS HOLDING PREFERENCE SHARE CAPITAL [SUB-SECTION 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 on **resolution**;

- a. Placed before the company which directly **affect the rights** attached to his preference shares, and
- b. For the **winding up** of the company, or for the **repayment or reduction** of its **equity or preference** share capital.

**Note:**

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

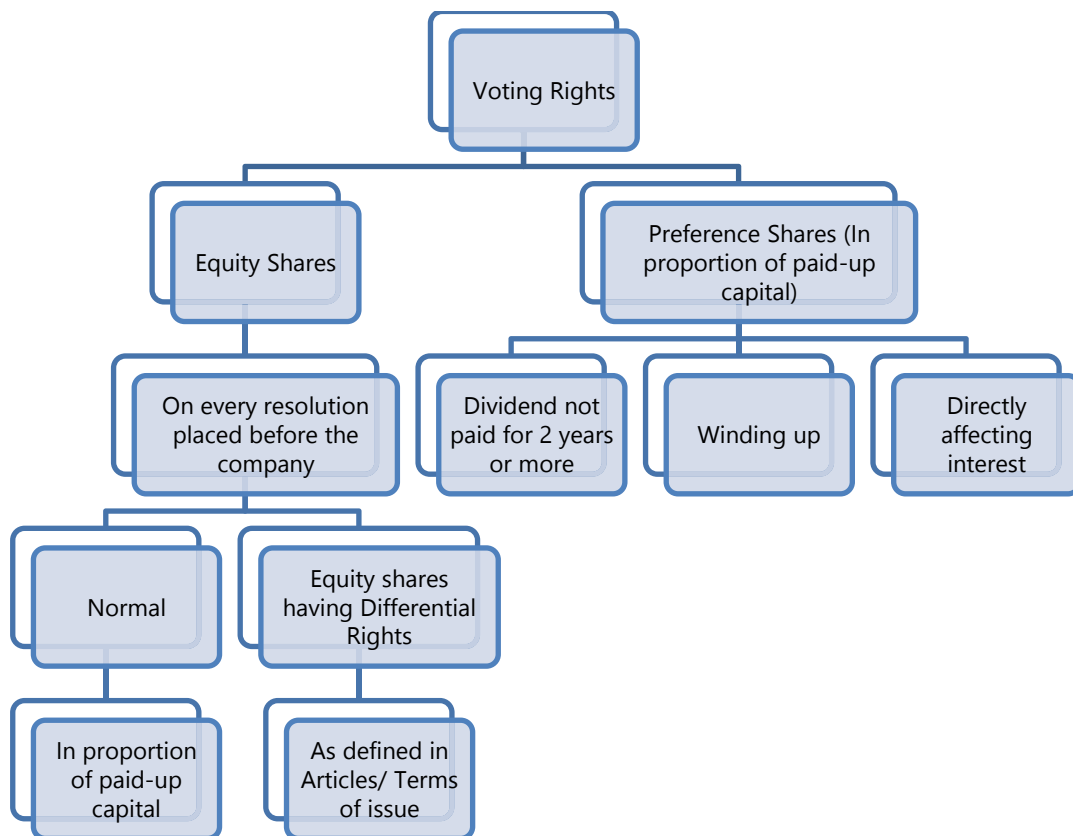
Second Proviso to section 47 (2) empowers preference shareholder with right to vote on all the resolutions placed before the company, in case where the dividend in respect of his class of preference shares has not been paid for a period of two years or more.

First Proviso to section 47 (2), provides that in case of resolutions wherein both equity shareholders and preference shareholders are entitled to vote, 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.

<sup>18</sup> Notification No. GSR 465 (E), dated 5th June, 2015.



Summary of section 47



**Example 4** – Indswift Pharma Labs Limited raised the capital of 300 crore through issue of single series of 8% preference share apart from 1200 crore ordinary shares. Indswift last paid dividend to such preference share holder, for 2019-20.

Preference shareholder w.e.f 1<sup>st</sup> April 2022 assume the right to vote on any resolution placed before company. But till 31<sup>st</sup> March 2022 they can vote only on that resolution which directly affect the rights attached to his preference shares or involve matter of the winding up of the company, or for the repayment or reduction of its equity or preference share capital.

The proportion of voting right of equity shareholders to the voting rights of the preference shareholders shall be 4:1.

**Section 47 shall not apply to;**

1. A Specified IFSC Public Company, where memorandum of association or articles of association of such company provides for it.<sup>19</sup>
2. A private company, where memorandum or articles of association of the private company so provides, however, this exemption shall be available to only that 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.<sup>20</sup>



## 5. VARIATION OF SHAREHOLDERS' RIGHTS [SECTION 48]

A shareholder who was given the right to purchase the shares of the company on a pre-emptive basis was held to constitute a special class distinguishing him from other shareholders who did not have any such right, and consequently, his right was not permitted to be taken away without his consent.<sup>21</sup> If it is proposed to change the rights of any class, certain procedure has to be followed.

Section 48 allows the variation, if **three conditions** (First two stated by sub-section 1, while third and last one by sub-section 2) has been met.

**First** - There should be a **provision in the memorandum or articles** of the company entitling it to vary such class rights, in absence of same; the **terms of issue** of the shares of that class **not prohibiting such a variation**.

**Second** - The holders of **at-least 75% of the issued shares** of that class must have given their **consent in writing** or pass a **special resolution** sanctioning the variation at a **separate class meeting**.

Proviso to sub-section 1, provides 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.

<sup>19</sup> GSR 8 (E), dated 4th January, 2017

<sup>20</sup> GSR 464 (E), dated 5<sup>th</sup> June, 2015 as amended by GSR 583 (E), dated 13<sup>th</sup> June, 2017

<sup>21</sup> Cumbrian Newspapers Group Ltd v Cumberland Sf Westmorland Herald Newspaper & Printing Co Ltd (1987) 2 Comp LJ39.

**Third** - The holders of at least 10 per cent of the shares of that class who did not consent to or vote in favour of the resolution may apply to the Tribunal and then variation shall not take effect unless and until it is confirmed by the Tribunal.

#### Procedural Aspects for confirmation from tribunal

An application should be made **within 21 days** of the date of consent or resolution. It can be made by one (or more of their number) as they may appoint in writing; on behalf of the shareholders entitled to make the application

**Sub-section 3** provides, the decision of the Tribunal have **binding effect** upon shareholders of the class. Further **sub-section 4** requires the company to **file a copy** of the order with the **Registrar within 30 days** of the date of the order.

**Example 5** – A resolution sanctioning the variation has been moved on 1<sup>st</sup> November 2022, the application with tribunal shall be filled by 22<sup>nd</sup> November 2022. Further if tribunal pass its order on 4<sup>th</sup> January 2023, then copy of order shall be filed with registrar by 6<sup>th</sup> March 2023.

#### Illustration - MCQ

*DBS Chemicals Limited issue ordinary share of different classes. DBS planned to vary rights of one the class wherein there were only 105 holders. 100 out of 105 holders own 0.5% shares of that class, whereas each of remaining 5 holders hold 10% shares of that class. Presuming 100 holder who own 0.5% shares already signed/authorised the consent letter sanctioning the variation, how many holders out of such 5 need to authorise the said letter to approve the variation.*

#### Options;

- a. 0
- b. 1
- c. 3
- d. 5

**Answer** – c. (Refer section 48(1))

The **holders of at-least 75% of the issued shares** of that class must have given their consent in writing or pass a special resolution sanctioning the variation at a separate class meeting.

**Mind it is 75% of issued shares' holders not 75% of holders.**

**Crux of some of landmark judgements – to better understand the 'variation'**

New issue of preference shares ranking *pari-passu* with the existing shares does not amount to variation so as to require the consent of preference shareholders.<sup>22</sup>

Cancellation of shares and reduction of capital also do not amount to variation of class rights.<sup>23</sup>

**6. CALLS ON SHARE [SECTION 49 TO SECTION 51]**

The liability of a shareholder to pay the full value of the shares held by him, which is currently partly paid-up is enforced by making "calls" for payment.

It is worth noting here that every shareholder is under a statutory liability to pay the full amount of his shares as Section 10(2) declares that "all money payable by any member to the company under the memorandum or articles shall be a debt due from him to the company".

But the liability to pay this debt arises only when a valid call has been made. Section 49 lay down the principle of uniformity, whereas section 50 deals with calls in advance and section 51 contains the provisions regarding dividend rights on paid-up amount.

**CALL SHALL BE ON UNIFORM BASIS [SECTION 49]**

Calls shall be made on a uniform basis on all shares that are falling under the same class.

**Note:**

1. Usually share with same nominal value are considered as same class, but shares of the same nominal value on which different sums have been paid shall not be deemed, for this purpose, to fall under the same class.
2. A shareholder on whom a regular call for payment has been served may choose to pay only a part of the sum due.

<sup>22</sup> White v Bristol Aeroplane Co Ltd (1953) 2 WLR 144.

<sup>23</sup> Essar Steel Ltd, re, (2005) 59 SCL457 (Guj)

Here it is important to consider the debt (of calls made) is not **an entire and indivisible debt**, therefore, the company may be bound to accept the amount tendered by the shareholder

**3.** How much to call on partly-paid share?

This will be the decision of board, subject to clauses to Article and terms of issue.

**Example 6** – Prism Glass Limited issued three series of equity shares, all carry the nominal value of ₹ 100, and the paid-up value for each series is 100, 80 and 55 respectively.

All will be considered as different class of shares. Since for first class share is fully paid-up, no call can be made, whereas in case of remaining two classes call can be made.

**Illustration – Q&A**

*Where a shareholder paid the first two calls after a great delay and neglected to pay the third call and the directors, being annoyed, and called upon him to pay the whole amount due. In your opinion is call valid?*

**Answer** - A call can't be made on some of the members only, unless they constitute a separate class of shareholders, hence such a call shall be invalid.<sup>24</sup>

**CALLS-IN-ADVANCE [SECTION 50]**

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, **although no part** of that amount **has been called up**.

**Note**

- 1.** Such advance payment will **not entitle** the member to more **voting rights** as compared with other members until all have been called upon to pay.
- 2.** **Interest can be paid** on such advance, **if permitted by article**. Here it is worth nothing that, where the rate of interest is permitted by the articles on such advance payment, same could be varied by shareholders in general meeting. **To illustrate**; a rate 6 percent may increase to 10% by shareholders.<sup>25</sup>

<sup>24</sup> Galloway v Halle Concerts Society, (1915) 2 Ch 233

<sup>25</sup> CIT v Manipal Industries Ltd, (1997) 12 SCL 15 (ITAT).

**Example 7** - 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.

#### Illustration – Q&A

*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. Advise the company about the validity of accepting money in advance.*

**Answer** - 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.

### PAYMENT OF DIVIDEND IN PROPORTION TO PAID-UP AMOUNT [SECTION 51]

The company if so authorised by article, may be permitted to pay dividends in proportion to the amount paid-up on each share.

The Board of Directors of a company may decide to pay dividends on pro rata basis if all the equity shares of the company are not equally paid-up. However, in the case of preference shares, dividend is always paid at a fixed rate.

## 7. ISSUE OF SHARES AT A PREMIUM OR DISCOUNT [SECTION 52 & SECTION 53]

### ISSUE OF SHARES AT A PREMIUM & APPLICATION OF PREMIUM [SECTION 52]

Since there is no restriction imposed by the Act on the sale of shares at a premium, hence if the market exists, a company may issue its shares at a price higher than their face/nominal value. But the Act does regulate the disbursement of the amount collected as premium through section 52.

**Note:**

1. The power to issue shares at premium need not be specifically provided by AOA.
2. SEBI guidelines have to be observed by listed entities, as regulations indicate when an issue has to be at par and when premium is chargeable.

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 8** - A share having face value of ₹ 10 is issued at a price of ₹ 14. The amount over and above the face value of ₹ 10 i.e. ₹ 4 is called premium.

**Practical Insight**

Lloyds Luxuries IPO opens on Sep 28, 2022, and closes on Sep 30, 2022. The date of listing on NSE SME was October 11, 2022 (Tuesday). Fixed issue price against the Face Value of ₹ 10 per share is ₹ 40 per share. Hence, premium charges is ₹30 per share.

**Transfer of premium to Securities Premium Account [Sub-section 1]**

Sub-section 1 lay-down following principles that shall be observed in regards to premium;

- a. Premium may be received in **cash** or in **kind**.
- b. The amount of premium so received, whether in cash or kind, shall be carried to a separate account to be known as the **Securities Premium Account**.
- c. The amount to the credit of share premium account has to be maintained with the same sanctity as **paid-up share capital**
- d. It can be **reduced** only **in the manner** of **paid-up share capital can be reduced** under this act. Liberty is, however, given to use the fund in the sub-section 2 and 3.

**Note:**

1. The amount to the credit of the share premium account has to be shown as a separate item in the Balance-sheet under Schedule III, Part B of the Act and if it was disposed of either wholly or partly, then disclosure shall be made 'how it was disposed'?

2. The DCA was of opinion that the amount of premium can't be treated as a free reserve as it is in the nature of a capital reserve.<sup>26</sup>
3. A reduction of the premium account was allowed under a scheme which experts had approved as fair, just and proper.<sup>27</sup>

### Application of Premium received on Issue of Shares [sub-section 2 & 3]

**Sub-section 2** allow the companies to apply securities premium account for;

- a. Issue of **fully paid bonus shares**;
- b. **Writing off** the **preliminary expenses**;
- c. **Writing off** the **issue expenses** (expenses including commission paid or discount allowed on any issue of shares or debentures);
- d. **Premium** payable on the **redemption** (of any preference shares or of any debentures); or
- e. **Buy-back** (purchase of its own shares or other securities under section 68).

**Sub-section 3** has overriding effect over sub-section 1 and 2. It restricts the application of Securities Premium Account 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

For the purpose of;

- a. Issue of **fully paid bonus shares**;
- b. **Writing off** the **issue expenses** (expenses including commission paid or discount allowed on any issue of shares);
- c. **Buy-back** (purchase of its own shares or other securities under section 68).

### PROHIBITION ON ISSUE OF SHARES AT DISCOUNT [SECTION 53]

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.

<sup>26</sup> Circular No 3/77 of 15-4-1977

<sup>27</sup> Zee Tele Films Ltd, re, (2005) 124 Comp Cas 102 (Bom).



**Example 9** - A share having face value of ₹ 100 is issued at a lower price of ₹ 95. The differential amount of ₹ 5 is known as discount which is being allowed by the company.

Though title of section used the word prohibited, but indeed issue of share at discount is not fully prohibited, it is only restricted especially after the enactment of the Companies (Amendment) Act, 2017 (effective from 09th February 2018).

**Sub-section 1**, except the issue of 'Sweat Equity Shares' under section 54 of this Act, a company **shall not issue shares at discount**.

Further, **sub-section 2**, provides any share issued at discount by company is **void**.

Sub-section 2A, is overriding provision (to sub-section 1 and 2) inserted though Companies (Amendment) Act, 2017 empowers the company to issue shares at discount to its creditors as result of **converting their debt on company into shares** as a result of;

- a. Statutory resolution plan or
- b. 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.

**Sub-section 3** provides the penalties that can be imposed where any company fails to comply with the provisions of Section 53;

Liabe	Penalty
Every officer who is in default	Upto an amount equal to the amount raised through the issue of shares at a discount or five lakh rupees, <b>whichever is less</b>
Company	Refund all monies received with interest at the rate of twelve percent per annum from the date of issue of such shares

**Note:**

It is to be noted that the restrictions mentioned in Sections **52 and 53** shall 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.



## 8. ISSUE OF SWEAT EQUITY SHARES [SECTION 54]

### MEANING OF 'SWEAT EQUITY SHARES' [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.

Hence one can say, sweat equity shares are issued to keep the employees of a company motivated by making them partner in the growth of the company. Mind it, Sweat equity shares is a different concept from Employee stock option in multiple ways.

Section 54 lists out the conditions that shall be fulfilled by company prior to issue of sweat equity share apart from designates these at equal footing to equity shares.

### STATUS OF SWEAT EQUITY SHARES AND HOLDER THEREOF [SECTION 54(2)]

Sub-section 2 provides;

- a. 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 of the Act
- b. The holders of sweat equity shares shall rank ***pari-passu*** with other equity shareholders.

Pari-passu is a Latin phrase that means "on equal footing"

### CONDITIONS FOR ISSUE OF SWEAT EQUITY SHARES [SECTION 54(1)]

According to Section 54 (1), a company may issue sweat equity shares if all of the following conditions are fulfilled;

- a. Share of that class must be **already issued**
- b. Issue is authorised by a **special resolution** passed by the company;
- c. Resolution **specifies the details** regarding 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;
- d. The issue of sweat equity shares must be in **accordance with regulations/rules** as state in table;

Company	Applicable Provisions/Regulations
Listed on Recognised Stock Exchange	Regulations made by the Securities and Exchange Board in this behalf
Other than above	Rule 8 of the <i>Companies (Share and Debentures) Rules, 2014</i>

### Illustration – T&F

*A company that incorporated and commenced the business on 9<sup>th</sup> Nov 2022, can issue sweat equity share only after 8<sup>th</sup> Nov 2023.*

**Answer** - **False.** Currently there is no condition prescribed by section 54 (1) regarding age of company.

### Students are advised to take note;

Clause c to section 54(1) omitted by the Companies (Amendment) Act, 2017 w.e.f 7<sup>th</sup> May 2018 “not less than one year has, at the date of such issue, elapsed since the date on which the company had commenced business”.

## SOME OF THE IMPORTANT PROVISIONS CONTAINED IN RULE 8 OF THE COMPANIES (SHARE AND DEBENTURES) RULES, 2014

### Meaning of Employee (Explanation I to sub-rule 1)

Employee means

- a permanent employee of the company who has been working in India or outside India; or
- a director of the company, whether a whole-time director or not; or
- an employee or a director as defined above, either of subsidiary or holding company of concerned company; in India or outside India

### Meaning of 'Value additions (Explanation II to sub-rule 1)

The expression 'Value additions' means;

- Actual** or **anticipated economic benefits** derived or to be derived by the company from an expert or a professional

- b. For providing know-how or making available rights in the nature of **intellectual property rights**,
- c. By such person to whom sweat equity is being issued
- d. 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 (Sub-rule 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.

#### Limit on issue of Sweat Equity Shares (Sub-rule 4)

During a year, the **maximum amount/limit** for which sweat equity shares can be issued is higher of;

- a. Fifteen percent of the existing paid up equity share capital **or**
- b. Shares of the issue value of rupees five crore.

The issuance of sweat equity shares (cumulative, including all previous issues, if any) **shall not exceed twenty five percent**, of the paid-up equity capital of the Company at any time. This limit for Startup companies is fifty percent of paid up capital upto ten years from the date of its incorporation or registration.

#### Lock-in Period [Sub-rule 5]

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 [Sub-rule 6]

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.

Quoted market prices in an active market are the best evidence of fair value and should be used, where they exist, to measure the financial instrument.

**Valuation of IPR/know-how/value additions [Sub-rule 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 [Sub-rule 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:

Form of Non-cash consideration	Treatment
Depreciable or amortizable asset	Carried to the <b>balance sheet</b>
Other than above	Shall be recorded as <b>expense</b>

**Disclosure in the Directors' Report [Sub-rule 13]**

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.

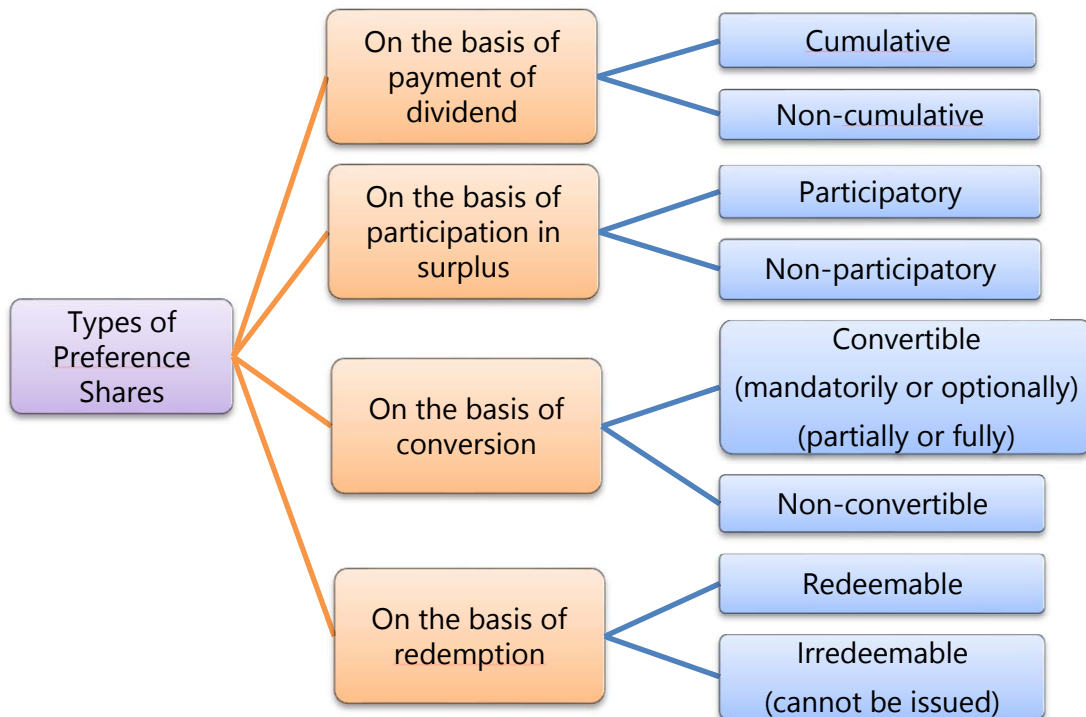
**Maintenance of Register [Sub-rule 14]**

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.



## 9. ISSUE AND REDEMPTION OF PREFERENCE SHARES [SECTION 55]

Following diagram depicts the types of preference shares:



### PROHIBITION ON ISSUE OF IRREDEEMABLE PREFERENCE SHARES [SUB-SECTION 1]

A company limited by shares shall not issue any preference shares which are irredeemable.

It worth noting that the amendment of 1988 to the Companies Act 1956, abolished the category of irredeemable preference shares.

### ISSUE AND REDEMPTION OF REDEEMABLE PREFERENCE SHARE [SUB-SECTION 2]

From the sub-section 1, it can be constructed reasonably that only redeemable preference shares can be issued by company limited by shares, sub-section 2

provides for conditions as applicable to the issue and redemption of redeemable preference shares.

### Authorised by Article of Association

A company limited by shares may issue redeemable preference shares only if so authorised by its articles.

**Example 10** – Medanta Healthcare Limited is planning to raise the capital through issue of preference share. Its article is silent about this. Board of Directors are of opinion that redeemable share can be issued.

Since in the given case article is silent, not authorise the issue of preference shares expressly, hence Medanta Healthcare Limited can't issue preference share. They may alter the article of association.

### Maximum Tenor of redeemable Preference Shares and exception thereto

Sub-section 2 also provides preference shares shall 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** laid-down by **sub-rule 1** are;

- a. A **special resolution** in the **general meeting** of the company shall be passed
- b. At the time of such issue of preference shares, the company should **not have subsisting default** in the;
  - i. Redemption of preference shares or
  - ii. Payment of dividend due on any preference shares.

**Sub-rule 2 and 3** enumerates the **matters to be specified** in resolution and explanatory statement to be annexed to the notice of such general meeting in which resolution has to be passed respectively.

**Sub-rule 4** requires a company that issues preference shares, to maintain a **Register of Members under Section 88**, which shall contain the particulars in respect of such preference shareholder(s).

Further **sub-rule 5** provides that if company wish to **list** its preference shares on a **recognized stock exchange**, shall issue such shares in accordance with the regulations made by the **SEBI** in this behalf.

**Exception to maximum tenor limit of twenty years (First proviso to section 55(2) read with explanation to section 55 and Rule 9 of the Companies (Share Capital and Debentures) Rules, 2014).**

For infrastructure projects specified in schedule VI of this Act, a company may issue preference shares for a period exceeding twenty years but not exceeding thirty years subject to the redemption of at least 10% of such preference shares annually, beginning from 21<sup>st</sup> year onwards or earlier, on proportionate basis, at the option of preferential shareholders.

### **Redemption of Preference Shares [Second proviso to section 55(2)]**

**Second proviso to section 55(2)** provide conditions for redemption and payment of premium on redemption, if any

- a. Preference shares shall be redeemed out of;
  1. **Profits** of the company which would otherwise be available for dividend or
  2. **Proceeds of a fresh issue** of shares made for the purposes of such redemption.
- b. Shares to be redeemed shall be **fully paid**.
- c. Where such shares are proposed to be redeemed **out of the profits** of the company;
  1. A sum equal to the **nominal amount** of the shares to be redeemed, **out of such profits** (profit & free reserves, which otherwise is available for dividend), shall be transferred to a reserve, called **Capital Redemption Reserve**
  2. The amount to the credit of Capital Redemption Reserve has to be maintained with the same sanctity as **paid-up share capital**
  3. Capital Redemption Reserve can be **reduced** only **in the manner** of **paid-up share capital can be reduced** under this Act.

### **For the purpose of this section**

1. Redemption of preference shares is not taken as reduction of the company's authorised share capital.
2. The company may issue new shares up to the nominal amount of the shares redeemed and the capital shall not be deemed to have been increased.



**Example 11** - 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 account 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.

**d. Source of premium, if any; payable at redemption of preference shares**

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.

Provided also that 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 falling under above scenario, 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.

Summary of above provisions are tabled below;

Category	Source	Timing (Shall be provided)
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	Out of the <b>profits</b> of the company	before such shares are redeemed

Premium payable on redemption of any preference shares issued on or before the commencement of this Act	Out of the <b>profits</b> of the company <b>or</b> out of the company's <b>securities premium account</b>	
Any other case		

### Issue of further Redeemable Preference Shares (if a Company is unable to redeem existing preference shares or pay dividend) [Sub-section 3]

Where a company is not in a position to redeem any preference shares or to pay dividend on such preference shares (called unredeemed preference shares) in accordance with the terms of issue; then such company may issue further redeemable preference shares to the holder of unredeemed preference shares; equal to the amount due, including the dividend thereon; with the consent of the holders of three-fourth in value of such unredeemed preference shares, and approval of the tribunal on a petition made by it in this behalf.

In this way the unredeemed preference shares shall be deemed to have been redeemed.

Where a company is not in a position to redeem any preference shares or to pay dividend on such preference shares (called unredeemed preference shares) in accordance with the terms of issue;

Then such company may issue further redeemable preference shares to the holder of unredeemed preference shares;

Equal to the amount due, including the dividend thereon;

With the consent of the holders of three-fourth in value of such unredeemed preference shares, and approval of the tribunal on a petition made by it in this behalf.

In this way the unredeemed preference shares shall be deemed to have been redeemed.

**Note:**

In regards to preference shares held by shareholder who have not consented to the issue of further redeemable preference shares, the tribunal shall order the redemption forthwith; while giving approval under section 55(3)

**Example 12** – Bell Homes Furnisher Limited (BHFL) unable to redeem the preference shares as they become due. Hence BHFL decided to issue further preference share against unredeemed preference shares. Holder holding 93% of such unredeemed preference shares in value, gave their consent; tribunal also assented to issue of further preference shares. The 18 holders who own remaining 7% seek redemption of shares held by them.

In this case while giving approval under section 55(3), tribunal shall order the redemption forthwith of shares (7% in value) held by dissenting 18 holders.

**Utilisation of CRR Account [Sub-section 4]**

The capital redemption reserve account may be applied in paying up unissued shares of the company to be issued to the members as fully paid bonus shares.

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

The procedures and formalities for the transfer of the securities as laid down by sections 56-59 are largely applicable to securities that are in other form than demat form.

### TRANSFER AND TRANSMISSION OF SECURITIES OR INTEREST OF MEMBER IN COMPANY [SECTION 56]

#### Requirement for Registering the Transfer of Securities [Sub-section 1]

**Except**, where the transfer is between persons both of whose names are entered as holders of beneficial interest in the **records of a depository**

A company **shall register a transfer** of;

- a. securities of the company, or

- b. the interest of a member in the company in the case of a company having no share capital,

**Only if**, following **conditions** fulfilled prior to such registration;

- a. The **instrument of transfer** must be **executed** both by the transferor and the transferee.
- b. The instrument must specify the **name, address and occupation**, if any, of the transferee.
- c. The instrument of transfer should be **duly stamped and dated**.
- d. The instrument of transfer should be in the **prescribed form**. As per Rule 11 (1) of *the Companies (Share Capital and Debentures) Rules, 2014*, Form No. SH-4 is to be used, in case securities are held in physical form
- e. The instrument should be delivered to the company along with the **certificate relating to the shares** transferred **within 60 days** from the date of execution. If the share certificate is not in existence, the **letter of allotment** of securities should be filed.

The proviso to Section 56(1) says that where **the instrument of transfer has been lost or it has not been delivered** within the prescribed period (i.e. 60 days from the date of Execution), the company may register the transfer on such terms as to **indemnity** as the Board may think fit.

**Transfer of partly paid Shares on an application of transferor alone (Sub-section 3 read with rule 11 (3) of the Companies (Share Capital and Debentures) Rules, 2014**

Where an **application is made by the transferor alone** and relates to partly paid shares, 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 13** - Himanshu has received a notice from Chaitanya Progressive Books Private Limited on 7<sup>th</sup> August, 2023 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 21<sup>st</sup> August, 2023.

**Exemptions<sup>28</sup> in case of government companies/securities**

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 given.

**Full exemption** from conditions laid-down by section 56(1) in respect to **transfer of securities held by nominees of the Government.**

**Partial exemption in** respect to **transfer of bonds issued by a Government company.** Only 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. There is no requirement of proper instrument of transfer, to be duly stamped and executed by or on behalf of the transferor and by or on behalf of the transferee.

**Power to Register Transmission not affected by section 56 (1) (Sub-section 2)**

The power of company to register transmission shall not be affected by the conditions imposed by Section 56 (1) for registration of transfer.

Hence company is empowered to register transmission of right, if it receives an intimation from any person to whom such right has been transmitted. There is no need for submission of instrument of transfer in case of transmission.

**Transmission (vis-à-vis transfer).**

The word '**transmission**' means devolution of title to securities otherwise than by transfer, for example, devolution by death, succession, inheritance, bankruptcy, marriage, etc. On registration of the transmission of securities, the person entitled to transmission of securities becomes the holder and is entitled to all rights and subject to all liabilities arising therefrom.

While transfer of shares is brought about by delivery of a proper instrument of transfer (viz, transfer deed) duly stamped and executed, transmission of shares is done by forwarding the necessary documents (such as a notarised copy of death certificate) to the company.

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<sup>28</sup> In terms of Notification No. GSR 463 (E), dated 5<sup>th</sup> June, 2015

**Few cases of transmission for better understanding** - In the following cases (mind it this list is not exhaustive, only illustrative), transmission of shares shall take place;

1. **Death:** When a shareholder expires, his shares need to be transmitted to his legal representative.
2. **Insolvency:** When a shareholder becomes insolvent, his shares are to be transmitted to his Official Receiver.
3. **Lunacy:** When a shareholder becomes lunatic, his shares are to be transmitted to his administrator appointed by the Court.

### **Transfer of Security of the Deceased Person by his Legal Representative [Sub-section 5]**

The transfer of any security (or other interest in company) made by legal representative of a deceased person, shall be valid as if such legal representative is holder at the time of the execution of the instrument of transfer; even if, in actual such legal representative is not a registered holder.

This sub-section is basically bringing ease to legal heir with deeming effect of being holder of security or other interest in company of a deceased person.

**Example 14** - Richa Daniel, after having obtained succession certificate, succeeded to 7,000 shares of ₹ 100 each allotted to her late father Alexander 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 Alexander 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.* Alexander Daniel shall be deleted. Further, new share certificates will be issued in the name of Richa Daniel, the legal representative of Alexander Daniel.

#### Time Period for Delivery of certificates [sub-section 4]

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
In the case of subscribers to the memorandum.	Within a period of <b>two months</b> from the date of <b>incorporation</b> .
In the case of any allotment of any of its shares by a company.	Within a period of <b>two months</b> from the date of <b>allotment</b> .
In the case of a transfer of securities.	Within a period of <b>one month</b> from the date of receipt of the <b>instrument of transfer</b> by the company
In the case of a transmission of securities.	Within a period of <b>one month</b> from the date of receipt of the <b>intimation of transmission</b> by the company
In the case of any allotment of debenture.	Within a period of <b>six months</b> from the date of <b>allotment</b> .
In the case of all securities by specified IFSC public and private company <sup>29</sup>	Within a period of <b>sixty days</b> after incorporation, allotment, transfer or transmission.

<sup>29</sup> GSR 9 (E), dated 4th January, 2017

**Note:**

In case 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. (Proviso to sub-section 4)

**Example 15** – A request for transfer of shares has been received by Ind-swift Pharma Labs Limited in form SH-4 along with instrument of transfer on 25<sup>th</sup> November 2022. The company shall deliver the certificate to that effect by 24<sup>th</sup> December 2022.

**Penalty [Sub-section 6]**

Liabe	Default	Penalty
Company <b>and</b> every officer of the company who is in default	In complying with the provisions of sub-sections (1) to (5) to section 56	₹ 50,000

**Liability of Depository [Sub-section 7]**

Where any depository or depository participant, with an intention to defraud a person, has transferred shares, it shall be liable under Section 447 along with the liability mentioned under the Depositories Act, 1996<sup>30</sup>.

**Note:**

1. 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.
2. 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'.

<sup>30</sup> Act 22 of 1996



**PUNISHMENT FOR PERSONATION OF SHAREHOLDER [SECTION 57]**

If any person **deceitfully** personates;

- a. as an owner of any security **or**
- b. interest in a company, **or**
- c. as an owner of any share warrant or coupon issued in pursuance of this Act,

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;

- a. Imprisonment for a term which shall not be less than one year but which may extend to three years **and**
- b. Fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

Penalty	Minimum	Maximum up to
<b>Imprisonment</b>	One year	Three years
<b>And</b>		
<b>Fine</b>	One Lakh	Five lakh

**Note:**

Personation for acquisition of securities is offence under section 38 punishable under section 447. Mind it section 447 is general provision.

Gravity of offence committed by personation under section 38 and section 57 may be considered while imposing penalty out of range provided.

It is worth noting, offence of cheating by personation under section 416 of Indian Penal Code, 1860 is punishable under section 419 of code, with punishment of either description which may extend upto three year or with fine or with both.

Student may refer section 38 and section 447, both covered under chapter 3 of this module.

**Additional Reading on 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.

**REFUSAL OF REGISTRATION AND APPEAL AGAINST REFUSAL [SECTION 58]**

Shares are movable property, hence can be transferred by the shareholders in the manner prescribed by the Articles. The right to transfer shares is absolute in nature and inherently vested with the ownership of the shares. In no case Articles can take away the rights of members to transfer shares in absolute, by making shares non-transferable.

Shares of a public company are freely transferable, whereas a private company is required under section 2(68)(i) to restrict the right of the members to transfer the shares. The articles of association of private companies contain certain kind of restrictions on the transferability of shares. Generally, the restriction put by a private company is that of pre-emption whereby the members are required to offer their shares first to the existing members of the company before offering them to the outsiders.

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.

#### Notice of Refusal to be sent [Sub-section 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 and **stating reasons** thereto,

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.

#### Securities/other interest in Public Company [sub-section 2]

The securities or other interest of any member in a public company are **freely transferable**.

Any contract or arrangement between two or more persons in respect of transfer of securities shall be **enforceable as a contract**.

#### Appeal to Tribunal against Refusal [Sub-section 3]

The transferee may **appeal to the Tribunal** against the refusal by private company to register the transfer or transmission, within a period of;

- a. **Thirty days** from the date of **receipt of the notice** or
- b. **Sixty days** from the date on which the instrument of transfer or the intimation of transmission, was delivered to the company, in case **no notice has been sent by the company**.

**Example 16** – An application has been received by Private Company for transfer of share on 25<sup>th</sup> Nov 2022. The transferee didn't get any response from company, hence may advance an appeal to the tribunal by 24<sup>th</sup> January 2023.

#### Appeal to Tribunal against Refusal by a Public Company without sufficient cause [Sub-section 4]

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 **appeal to the tribunal**, within, within a period of

- a. **Sixty days** of such refusal or
- b. **Ninety days** of the delivery of the instrument of transfer or intimation of transmission, where no intimation has been received from the company.

**Example 17** – An application has been received by Public Company for transfer of share on 25<sup>th</sup> Nov 2022. The transferee didn't get any response from company, hence may advance an appeal to the tribunal by 23<sup>rd</sup> February 2023.

#### Order of Tribunal [Sub-section 5]

The Tribunal, while dealing with an appeal **may**, after hearing the parties, **either dismiss** the appeal, or **by order direct**;

- a. 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.

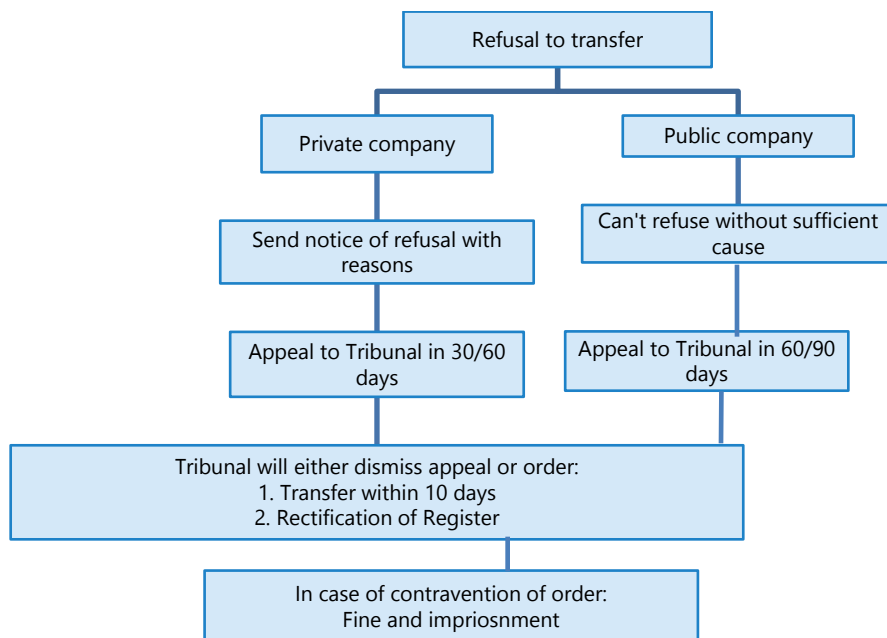
#### Contravention of the Order of the Tribunal [Sub-section 6]

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.

#### Summary of penalty

Penalty	Minimum	Maximum up to
Imprisonment	One year	Three years
<b>And</b>		
Fine	One Lakh	Five lakh

### Summary of section 58



### Illustration – T&F

Notice of refusal to register transfer of shares by private company shall be sent only to the transferee within 30 days, stating reasons of refusal therein.

**Answer** – False, notice of refusal shall be given to both transferee and transferor under section 58(1).

### RECTIFICATION OF REGISTER OF MEMBERS [SECTION 59]

It is the duty of the company to keep the register up to date so as to give at all times the accurate and correct position as to particulars of shareholding, because If a person's name appears in the register of members, he is presumed to be the shareholder or member, even if, in fact, he is not so. Contrarily, if a person's name is absent from the register, apparently he is not a member, although he may have done everything to entitle him to become one.

Section 59 entrust right to appeal with aggrieved person, apart from vesting power in tribunal to order for rectification of register of members.

#### Appeal by Aggrieved Person [Sub-section 1]

An **aggrieved person, member of company or company** may **appeal to 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** if **without sufficient cause**,

- a. the name of any person is **entered** in the register of members of a company, or
- b. the name of any person is **omitted**, after having been entered in the register, or
- c. 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.

**Note:**

The words "**unnecessary delay**" have not been defined in the Act and, therefore, it becomes a question of evidence to be decided on the facts of each case. A failure to register a transfer within one month of the application, which was contrary to the listing agreement, was held to be an unreasonable delay.

Every shareholder has an interest in the proper maintenance of the company's register of members. Any member can make an application without showing any injury or prejudice to him. Personal grievance is not necessary for **locus standi**.

**Order of the Tribunal [Sub-section 2]**

Tribunal may, **after hearing** the parties to the appeal either **dismiss the appeal** or by **order**;

- a. 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
- b. 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.

**Example 18** – After hearing both parties of appeal over removal of name of applicant from register of member without sufficient cause, tribunal pass an order to reinstate the name in register with payment of damages to holder as well cost of litigation. Company has to pay damages as ordered apart from rectification of the register.

**Rights of holder is protected [Sub-section 3]**

**Sub-section 3** protects the right of a holder of securities, to transfer such securities. Further, any person acquiring such securities shall be entitled to voting rights

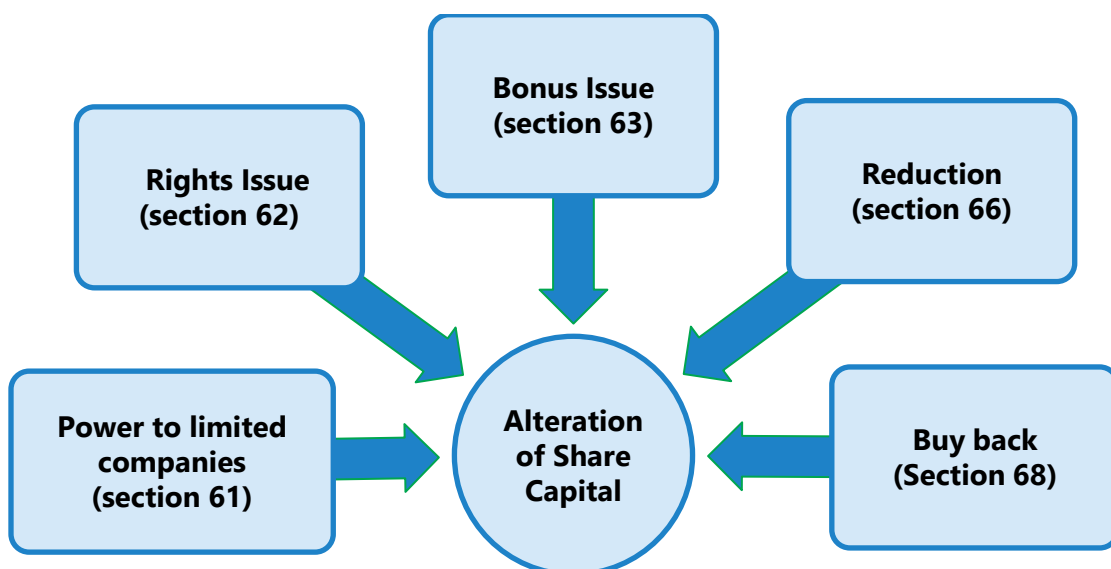
unless the voting rights have been suspended by an order of the Tribunal.

### Transfer of Securities contravenes certain Acts and Direction of Tribunal [Sub-Section 4]

Tribunal may, on an application (made by the depository, depository participant, company, 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**, where the transfer of securities is in contravention of any of the provisions of the;

- a. The Securities Contracts (Regulation) Act, 1956
- b. The Securities and Exchange Board of India Act, 1992
- c. The Companies Act, 2013 or
- d. Any other law for the time being in force

## 11. ALTERATION OF SHARE CAPITAL [SECTIONS 61-70]



**Definition:****1. 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.

**2. 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]**

A limited company with a share capital can alter the capital clause of its memorandum of association in any of the following ways, provided authority to alter is given by the articles.

- a. It may **increase** its authorised capital by such amount as it thinks expedient.
- b. **Consolidate** and **divide** the whole or any part of its share capital into shares of larger amount.
- c. **Convert** all and any of its fully paid up **shares into stock** or **vice-versa** into any denomination.
- d. **Sub-divide** the whole or any part of its share capital into shares of smaller amount.

The proportion between the amount paid and unpaid (if any) 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** those shares which have not been taken up and reduce its capital accordingly.

**Example 19** – A share with face value of ₹ 100, on which ₹ 80 is paid up, can be split into 10 shares of ₹ 10 nominal value each, with ₹ 8 being paid up.

**Note:**

Any of the above things can be done by the company by **passing a resolution** at a **general meeting**.



Approval of the **National Company Law Tribunal** requires only in the case wherein consolidation and division [suggested in point (b)] results in changes in the voting percentage of shareholders.

Within **30 days** of alteration, a **notice** must be given in Form SH-7 to the Registrar who will record the same and make necessary **alteration in the company's memorandum**. (Section 64 read with Rule 15 of the *Companies (Share Capital and Debentures) Rules, 2014*).

Further subsection 2 provides that the cancellation of shares **shall not be deemed to be a reduction** of share capital. Mind it, reduction of capital covered under section 66 of the Act.

### **FURTHER ISSUE OF SHARE CAPITAL – RIGHTS ISSUE; PREFERENTIAL ALLOTMENT [SECTION 62]**

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 prorata way to raise capital.

**Example 20** - 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.

#### **Practical Insight**

##### **Right Issue by Suzlon Energy Limited (October 2022)**

Suzlon Energy Limited (SEL) is among the world's leading renewable energy solutions provider in India operating in wind energy segment.

To part finance its needs for repayment/prepayment of certain borrowings (₹ 900.00 crore) and general corporate purposes (₹ 283.50 crore), SEL is offering a rights issue of 240 crore equity shares (Face Value ₹ 2) each at a price of ₹ 5 per share (Current Market Price of Share was ₹ 8.47) to mobilize ₹ 200.00 crore.

The company is offering the right shares in the ratio of 5 shares for every 21 shares held as of the record date of October 04, 2022. Rights entitlements can be renounced up till Oct 14, 2022 (Current Market Price of Rights Entitlement was ₹ 1.32).

The issue opens for subscription on October 11, 2022, and will close on October 20, 2022.

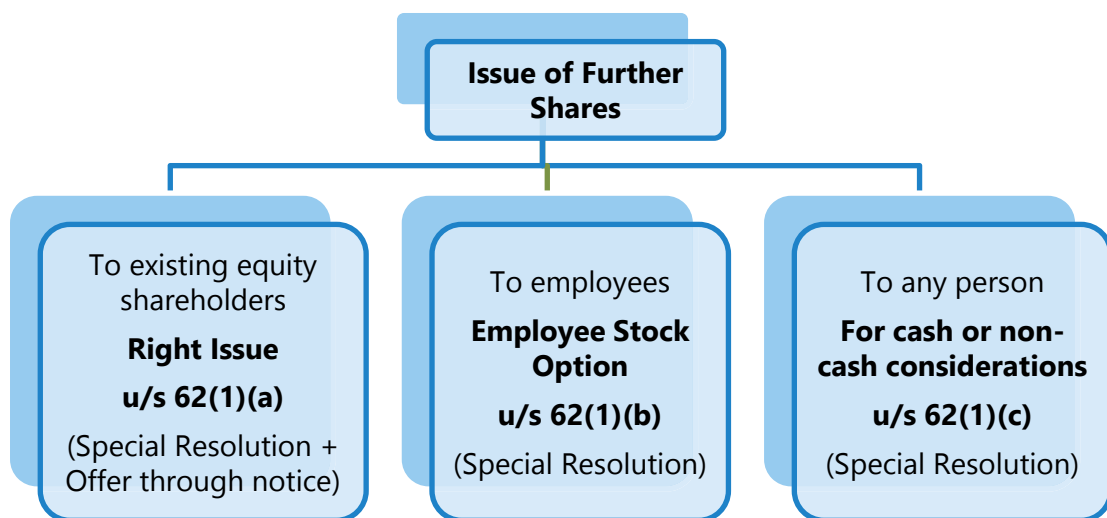
Only 50% amount (i.e. ₹ 2.50 per share) is to be paid on application and the balance on one or more calls by the company from time to time.

Post allotment, shares will be listed on BSE and NSE.

SEL is proposed to spend ₹ 16.50 crore for this Right Issue process.

Class of companies	Power to Right Issue	Applicable Provisions
Listed companies or companies intended to get its securities listed	23(1)(c)	Provisions of the Securities and Exchange Board of India Act, 1992 and the rules and regulations made thereunder
Public companies not covered above		Provisions of this Act and rules made thereunder
Private companies not covered above	23(2)(a)	

### Offering of issue of further Shares [Sub-section 1]



Whenever a company having a share capital, proposes to increase its subscribed capital by the **issue of further shares**, such shares shall be offered;

- a. To persons who are **holders** of equity shares (**existing** on date of such offer),
  1. in **proportion** to the **paid-up capital** on those shares held by them;
  2. by sending a letter of offer in form of **notice**, such notice **shall specify**;
    - i. Specify the **number of shares** to be offered
    - ii. Specify the **time period** within which the offer must be accepted. The time period should not be less than 15 days or such lesser number of days as may be prescribed but not exceeding 30 days from the date of the offer

**Note – Rule 12A** inserted in *the Companies (Share Capital and Debentures) Rules, 2014*, that provides the time period within which the offer shall be made for acceptance **shall be not less than seven days** from the date of offer<sup>31</sup>

- iii. Specify, if the offer is not accepted within the specified time, it shall be **deemed** to have been **declined**.
- iv. Confirm the right to renounce all or any of shares to existing holders, in favour of some other person; unless article otherwise provided.

**Note:**

1. If offer **declined by existing holder**, then at intimation of such decline or after **expiry of the specified time** given to him for exercise the right, the Board of Directors **may dispose of them** (such shares, in regard to which offer is declined) in such manner which is **not dis-advantageous to the shareholders and the company**.
2. While determining/checking proportion, then **as nearly as the circumstances admits** shall be acceptable.

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<sup>31</sup> G.S.R. 113(E) dated 11<sup>th</sup> Feb 2021

3. In case of a **Private Company**<sup>32</sup> and **Specified IFSC Public Company**<sup>33</sup>, any shorter time periods to accept the offer may be provided, if **ninety percent** of the members have given their **consent in writing** or in **electronic mode** for such shorter period

- b. To employees under a scheme of **employees' stock option**, subject to:
1. **Special resolution** passed by company, and
  2. Conditions as may be prescribed in **Rule 12** of the *Companies (Share Capital and Debentures) Rules, 2014*.

**Note:**

1. 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 (**Section 2(37)**)
2. Instead of special resolution, **ordinary resolution** will be sufficient, in following cases;
  - a. **Private company** which has not defaulted in filing its financial statements under Section 137 or Annual Return under Section 92.<sup>34</sup>
  - b. **Specified IFSC Public Company**.<sup>35</sup>
3. In case of a **listed company**, conditions prescribed by **SEBI (Share Based Employee Benefits) Regulations, 2014** shall be observed.

- c. To **any persons**, if so authorised by a **special resolution** even if they are not within the two categories mentioned above.

<sup>32</sup> GSR 464 (E), dated 5<sup>th</sup> June, 2015 as amended by GSR 583 (E), dated 13<sup>th</sup> June, 2017

<sup>33</sup> GSR 8 (E), dated 4<sup>th</sup> January, 2017

<sup>34</sup> GSR 464 (E), dated 5<sup>th</sup> June, 2015 as amended by GSR 583 (E), dated 13<sup>th</sup> June, 2017

<sup>35</sup> GSR 8 (E), dated 4<sup>th</sup> January, 2017

**Note:**

1. Where further shares are offered through manner specified in point iii above, then such offer can be for **cash or for a consideration other than cash**.
2. Further, in case of non-cash consideration, price to be determined by valuation report of a **registered valuer** subject to such conditions as may be prescribed in **Rule 13** of the *Companies (Share Capital and Debentures) Rules, 2014*.

**Example 21** - A company, listed at Bombay Stock Exchange, intends to offer its further 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 passing a special resolution as required in Section 62 (1) (c). Thus, new shares of a company limited by shares may be issued to non-members under certain circumstances.

**Illustration– Q&A**

*What shall be length of period specified by notice of offer of further issue for giving acceptance?*

**Answer** – Notice of offer of further shares shall specify the **time period** within which the offer must be accepted. The time period should not be less than 15 days or such lesser number of days as may be prescribed but not exceeding 30 days from the date of the offer

**Note – Rule 12A** inserted in the *Companies (Share Capital and Debentures) Rules, 2014*, provides the time period within which the offer shall be made for acceptance **shall be not less than seven days** from the date of offer.

**Dispatch of Notice to the existing Shareholders [sub-section 2]**

Notice referred in 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**.

In case of a **Private Company**<sup>36</sup> any shorter length (less than 3 days) of notice period shall also be acceptable, if **ninety percent** of the members have given their **consent in writing** or in **electronic mode** for such shorter period.

**Example 22** – Notice of right issue dispatch to holders at their registered e-mail ID in two days advance to opening of issue. Out of 4230 members 3075 member holding 94% of shares acknowledges the mail and consented to shorter length of notice. Despite the mode of dispatching notice and furnishing consent by members to shorter length is valid, the notice stands invalid because at-least 90% of members shall give their consent to shorter length of notice; where as in given case nearly 72.70% (3075 out of 4230) given consent. Here number of members is to be considered not their holding.

**Exception – Section 62 shall not be applicable on conversion of debenture or loan into equity shares [Sub-section 3]**

Conversion of debenture (pursuant to conditions of issue) or loan (pursuant to conditions of grant of loan) into equity shares leads to **increase in the subscribed capital** of a company.

Sub-section 3 states **section 62 shall not be applicable** to **such increase** in subscribed capital provided;

- a. Those **terms and conditions** under which such conversion took place,
- b. Must be approved by company in general meeting through **special resolution**,
- c. **Prior** to issue of debenture and grant of loan.

**Compulsorily conversion of Debentures/Loan from government into Shares [Sub-section 4, 5 and 6]**

**Sub-section 4 empowers the government to direct by order;**

- a. **Conversion** of **debentures** (issued to government) or **loans** (issued by government) to company, either **full or in part** thereof **into shares** of such company,
- b. If that Government considers it necessary in the **public interest** so to do,

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<sup>36</sup> GSR 464 (E), dated 5<sup>th</sup> June, 2015 as amended by GSR 583 (E), dated 13<sup>th</sup> June, 2017

- c. on such **terms and conditions** as appear to the Government to be **reasonable in the circumstances** of the case,
- d. even if **terms of the issue** of such debentures or the **raising** of such loans **do not providing for an option for such conversion**.

**Proviso to sub-section 4 provides remedy to company against hostile conversion.**

Where the terms and conditions of such conversion are not acceptable to the company, it may appeal to the **Tribunal**, within **sixty days** from the date of communication of such order.

Tribunal after hearing the company and the Government shall pass such order as it deems fit.

**Sub-section 5** requires, **government shall consider following** while determining the terms and conditions of conversion;

- a. the financial position of the company,
- b. the terms of issue of debentures or loans, as the case may be,
- c. the rate of interest payable on such debentures or loans, and
- d. such other matters as it may consider necessary.

**Sub-section 6** states pursuant to order of government for conversion of debenture and loan into equity shares, under sub-section 4, 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 and **memorandum shall stand altered**.

Section 62 shall not apply to Nidhi Company. While complying with such exception, the Nidhi Companies shall ensure that the interests of their shareholders are protected.<sup>37</sup>

### ISSUE OF BONUS SHARES [SECTION 63]

The term bonus share is not defined anywhere in the Companies Act 2013. However, the characteristics of bonus shares along with condition and manner of issue of fully paid-up bonus share by a company to its member highlighted by section 63.

<sup>37</sup> GSR 465 (E), dated 5th June, 2015

In commercial parlance, the bonus shares are shares issued proportionately by a company to its current shareholders as fully paid-up shares free of cost.

**Example 23** – If a company decided to issue bonus share in ratio of 1:2 (one for every two shares held), then the holder of 100 shares of a company will get 50 bonus share without making any payment. There his holding of shares will now be 150 instead of 100.

#### Status of Bonus Shares from lens of the Judiciary

**Hon'ble Supreme Court** in case of **Standard Chartered Bank v Custodian**<sup>38</sup>

Bonus share is an accretion. A bonus share is issued when the company capitalises its profits by transferring an amount equal to the face value of the share from its reserve to the nominal capital.

In other words, the undistributed profit of the company is retained by the company under the head of capital against the issue of further shares to its shareholders. Bonus shares have, therefore, been described as a distribution of capitalised undivided profit.

In the case of issue of bonus share there is an increase in the capital of the company by transferring of an amount from its reserve to the capital account and thereby resulting in additional shares being issued to the shareholders.

A bonus share is a property which comes into existence with an identity and value of its own and capable of being bought and sold as such.

#### Sources for issue of Bonus Share [Sub-section 1]

A company may issue **fully paid-up bonus shares** to its members out of;

- a. its free reserves (other than revaluation reserve);
- b. the securities premium account; or
- c. the capital redemption reserve account.

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<sup>38</sup> (2000) 6 SCC 427



Bonus shares shall not be issued by capitalising reserves created by the revaluation of assets **[Proviso to section 63(1)]**



Bonus shares **may** be issued from

- Free Reserves
- Securities Premium Reserve
- Capital Redemption Reserve

Bonus shares **shall not** be issued from

- Revaluation Reserve

### Pre-requisites for issue of bonus shares [Sub-section 2]

No company may capitalise its profits or reserves for the purpose of issuing fully paid-up bonus shares, if;

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

#### Note:

1. The bonus shares **shall not** be issued in lieu of dividend (**Sub-section 3 to section 63**)
2. **Proviso to sub-section 5 to section 123 of this act** carries **confirmatory** provisions to those contained in **section 63**.

According to the proviso to **Section 123(5)** of the Act, 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.

#### Illustration – True/False

*Bonus share can be issued to partly paid shares in proportion to paid-up value.*

**Answer** – False, Bonus shares can only be issued against fully paid, the partly paid-up shares, if any outstanding on the date of allotment, are made fully paid-up.

### NOTICE TO BE GIVEN TO REGISTRAR FOR ALTERATION OF SHARE CAPITAL [SECTION 64]

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

#### Filing of Prescribed Notice [sub-section 1]

Company shall file a notice in the Form No. SH-7 as per Rule 15 of *the Companies (Share Capital and Debentures) Rules, 2014* with the **Registrar**, along with an **altered memorandum**; within **thirty days** of **alteration** (including increase or decrease) to its capital in case of;

- a. Alternation of capital in manner specified in section 61 (1),
- b. Order made by the Government under section 62(4) read with 62(6) has the effect of increasing authorised capital of a company; or
- c. Redemption of any redeemable preference shares,

#### Penalty for Default in Filing of Notice [Sub-section 2]

Where any company fails to file notice as manner prescribed in sub-section 1 then 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.

### Summary of penalty

Liabe	Penalty
Company	<b>Five hundred rupees</b> for <b>each day</b> during which such default continues, subject to a <b>maximum of five lakh rupees</b>
Every officer who is in default	<b>Five hundred rupees</b> for <b>each day</b> during which such default continues, subject to a <b>maximum of one lakh rupees</b>

### REDUCTION OF SHARE CAPITAL [SECTION 66]

Conservation of capital is one of the main principles of company law, because any reduction of capital diminishes the fund; out of which creditor and other debt holders are to be paid, therefore it adversely impact them. But sometimes it may become necessary for the company to bring about a reduction in its capital. Therefore, closely fenced power is given by Section 66.

#### Reduction of Share Capital by Special Resolution to be confirmed by Tribunal [Sub-section 1]

A company being '**company limited by shares**' or '**company limited by guarantee and having a share capital**' may **reduce the share capital in any manner** and in **particular manners** as state below -

- a. Extinguish or reduce the liability on any of its shares in respect of the share capital not paid-up; or
- b. Cancel any paid-up share capital which is lost or is unrepresented by any available assets; or
- c. Pay off any paid-up share capital which is in excess of the wants of the company
  - a. **Subject to** Passing a **special resolution**; and
  - b. **Alter its memorandum** by reducing the amount of its share capital and of its shares accordingly; and
  - c. Repayment of any deposits accepted by it, either before or after the commencement of this Act, or the interest payable thereon shall not be in arrear.

**Example 24** - 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.

### Issue of Notice by the Tribunal [Sub-section 2]

The Tribunal shall give notice of every application made to it;

- a. to the Central Government (power delegated to Regional Directors)
- b. to the Registrar and
- c. to the Securities and Exchange Board, in the case of listed companies, and
- d. the creditors of the company

Tribunal shall **consider** the representations (if any) made by them within a **period of three months** from the date of receipt of the notice.

#### Note:

1. Where no representation has been received within the said period of three months, it shall be presumed that they have **no objection** to the reduction.
2. Considering representations is statutorily required, not admitting it in full.

**Example 25** – An application for reduction of capital received by NCLT on 22<sup>nd</sup> November 2022 from a unlisted company, he send a notice of such application to concerned RD, RoC as well as to creditor on 28<sup>th</sup> November 2022. Notice to RD and RoC sent in registered post which reached to them on 1<sup>st</sup> December 2022. Hence in given case RD and RoC can make representation till 28<sup>th</sup> Feb 2023. If any representation made thereafter, Tribunal is not bound to consider that.

### Order of Tribunal [Sub-section 3]

The Tribunal **may make an order confirming the reduction** of share capital on such terms and conditions as it deems fit only if it is satisfied that -

- a. The **debt or claim** of every creditor of the company has been either
  - i. **Discharged** or
  - ii. **Determined** or

- iii. Has been **secured** or
  - iv. His **consent is obtained**.
- b.** 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.

How tribunal determine that, 'whether accounting treatment, proposed by the company for such reduction is in conformity with the accounting standards specified in Section 133 or not'?

While making an application, a certificate to that effect by the company's auditor has been filed with the Tribunal.

#### **Publication of Order of Confirmation of Tribunal [Sub-Section 4]**

The order of confirmation of the reduction of share capital by the Tribunal shall be published by the company in such **manner as the Tribunal may direct**.

#### **Delivery of Certified Copy of Order of Tribunal to Registrar [Sub-section 5]**

Within **thirty days** of the **receipt of the copy of the order**, the company shall deliver; to the Registrar, a certified copy of the tribunal order and minutes (containing special resolution) 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
- d.** the amount, if any, at the date of registration deemed to be paid-up on each share,

Registrar on receipt, shall register the same and issue a certificate to that effect.

#### **Exemption to Buy-Back [Sub-section 6]**

Nothing in this section shall apply to buy-back of its own securities by a company under Section 68.

#### **No Liability of Members [Sub-Section 7]**

A member (whether in past or present) shall be liable to pay the amount (call or contribution) maximum upto difference (if any) between the amount deemed to have been paid on his shares and the nominal value of the reduced shares.

'Deemed to have been paid' here signify reduced amount against the amount that have been actually paid on the share.

**In case where Creditor is entitled to object but was not included in the list of Creditors [Sub-section 8]**

If a reduction of share capital took place; and where a creditor is entitled to object to a reduction of share capital, but his name and interest (his debt or claim on company) not entered on the list of creditors, either because of:

- a. His ignorance of the proceedings for reduction or
- b. Nature of his interest (debt or claim)

Then in respect of his interest, company commits a default, within the meaning of section 6 of the Insolvency and Bankruptcy Code, 2016.

**Action to make claim of creditor good (Remedy available to such unpaid creditor)**

**If company is running its operation**

- a. Every person, who was a member of the company on the **date of the registration of the order for reduction** by the Registrar,
- b. Shall be liable to contribute to the **payment of such debt or claim**,
- c. But **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.

**If 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,

- a. Settle a list of persons so liable to contribute, and
- b. Make and enforce calls and orders on the contributories settled on the list, as if they were ordinary contributories in a winding up.

**Example 26** – Name and Interest of Mr. Nilanjan Iyer, a creditor of Modern Furniture Limited has been kept outside the list of creditor while company went into reduction of its capital; later when Mr. Iyer came to know about this he wish to take legal action against company under IBC 2016, as limitation period is not

expired yet. Mr. Iyer entitled to do so, exclusion of his name construed as offence under IBC as well.

**Note:** Period of limitation is a maximum period set by statute within which a legal action can be brought or a right enforced. The Limitation Act 1963 governing the provisions regarding period of limitation.

### Rights of Contributories not affected [Sub-section 9]

Sub-section 9 is an overriding provision that prevents the rights of contributories inter-se. Nothing in sub-section 8 shall affect the rights of the contributories among themselves.

### Liability of Officers [Sub-section 10]

Officer of the company shall be liable for punishment under **section 447**, if he:

- a. **Knowingly conceals** the name of any creditor entitled to object to the reduction or **abets** or is **privy** to any such concealment; or
- b. **Knowingly misrepresents** the nature or amount of the debt or claim of any creditor or **abets** or is **privy** to any such misrepresentation.

**Note:**

1. **Abet** means to encourage or incite another to commit a crime
2. **Privy** signifies a coparticipant; one who has an interest in a matter
3. 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'.

### RESTRICTION ON PURCHASE BY COMPANY OR GIVING OF LOANS BY IT FOR PURCHASE OF ITS SHARES [SECTION 67]

Conservation of capital is one of the main principles of company law, because the share capital of a company is the only security on which the creditors rely.

Therefore, a company cannot buy its own shares because reduction of capital, results in diminishing of the fund out of which creditors are to be paid; hence adversely affects the creditors. However, this restriction is not absolute.

### Reduction according to the applicable Provisions [Sub-section 1]

'Company limited by shares' or 'company by guarantee that having a share capital' **shall not** buy its own shares **unless** the consequent **reduction of share capital is effected** under the provisions of this Act.

### Restriction on giving Loan, Guarantee or provision of Security, etc. [Sub-section 2]

**Public company** shall not give any financial assistance;

- a. Whether directly or indirectly and whether by means of a loan, guarantee, the provision of security or otherwise
- b. 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.

### Exceptions [Sub-section 3]

Company may provide the financial assistance, in following case;

- a. Lending of money by a banking company in the **ordinary course of its business**;

#### Note:

1. The words "lending in the ordinary course of business" are not defined
2. Banks have to make loans in the ordinary course of their business and they can hardly supervise the purpose for which the borrower uses the loan money. Hence if a borrower from a bank uses the money for purchasing the bank's shares, the bank and its officers will be protected from liability.
3. An English court held that where money is given for the very purpose of purchasing the bank's shares that would not be lending in the ordinary course of business, then the provision would said to be violated.

- b. The provision of money for the purchase of fully paid shares in the company or its holding company by trustees for and on behalf of the company's employees in accordance with any scheme (**Employee share schemes**) approved by company through special resolution with such requirements



as may be prescribed in **Rule 16** of the *Companies (Share Capital and Debentures) Rules, 2014*,

**Note:**

1. In case the shares of the company are **listed** - Such purchase of shares shall be made only through a recognized stock exchange and not by way of private offers or arrangements.
2. Where shares of a company are **not listed** - the valuation at which shares are to be purchased shall be made by a **registered valuer**.
3. The **value of shares** to be purchased or subscribed in the aggregate **shall not exceed five percent** of the aggregate of paid up capital and free reserves of the company;
4. 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 for the relevant financial year, namely:
  - (a) Names of the employees who have not exercised the voting rights directly;
  - (b) Reasons for not voting directly;
  - (c) Name of the person who is exercising such voting rights;
  - (d) Number of shares held by or in favour of, such employees and the percentage of such shares to the total paid up share capital of the company;
  - (e) Date of the general meeting in which such voting power was exercised;
  - (f) Resolutions on which votes have been cast by persons holding such voting power;
  - (g) Percentage of such voting power to the total voting power on each resolution;
  - (h) Whether the votes were cast in favour of or against the resolution.

- c. **Lending** money by a company **to its employees** (other than its directors or key managerial personnel), **not exceeding six month salary** of the employees to enable them to buy or subscribe **fully paid shares** in the **company or its holding company** and to hold them by way of **beneficial ownership**.

### Redemption of Preference Shares Permitted [Sub-section 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.

### Punishment for Contravention [Sub-section 5]

If a company contravenes the provisions of this section, the punishment shall be;

Liabe	Penalty		
<b>Company</b>	Fine which shall not be less than one lakh rupees but may extend to twenty-five lakh rupees		
Every <b>officer</b> of the company who is in default	Imprisonment for a term which may extend to three years	and	Fine which shall not be less than one lakh rupees but may extend to twenty-five lakh rupees.

1. Section 67 shall not apply to **private companies**<sup>39</sup> (if not defaulted in filing its financial statements under Section 137 and Annual Return under Section 92) and **Specified IFSC Public Company**<sup>40</sup> in whose case all of following 3 condition fulfilled;
  - 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 anybody 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.

<sup>39</sup> GSR 464 (E), dated 5th June, 2015 as amended by GSR 583 (E), dated 13th June, 2017

<sup>40</sup> GSR 8 (E), dated 4th January, 2017

2. Section 67 (1) shall not apply to **Nidhi Companies**, 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 Nidhi Companies shall ensure that the interests of their shareholders are protected.<sup>41</sup>

### **POWER OF COMPANY TO PURCHASE ITS OWN SECURITIES [SECTION 68] - BUY BACK OF SECURITIES**

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

#### **Sources of Funds for Buy-Back of Shares [Sub-section 1]**

A company may purchase its own shares or other specified securities. The purchase should be made out of its:

- a. Free reserves; or
- b. Securities premium account; or
- c. Proceeds of the issue of any shares or other specified securities.

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

Specified securities includes employees' stock option or other securities as may be notified by the Central Government from time to time (Explanation I to section 68)

#### **Conditions for Buy-Back [Sub-section 2]**

A company may purchase its own shares or other specified securities, if met with following conditions, namely;

- 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;

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<sup>41</sup> GSR 465 (E), dated 5th June, 2015

A **special resolution is not necessary** where:

1. The buy-back is, **not exceeding ten percent** of the total paid-up equity capital and free reserves of the company; **and**
  2. Such buy-back has been **authorised by the Board resolution** passed at its meeting;
- c. The amount involved in buy-back **should not be more 25%** of the **aggregate of paid-up capital and free reserves** of the company; further in case of **buyback of equity shares**, the maximum limit is **25% of its total paid-up equity capital in any financial year**.
  - d. After the buyback, the ratio between the **debts** (secured and unsecured) owed by the company should **not be more than twice** the **paid-up capital and free resources** of the company (Central Government may prescribe a higher ratio for a class or classes of companies).
  - e. Shares or other specified securities for buy-back shall be **fully paid-up**;
  - f. The buy-back should be in accordance with the **Rule 17** of *the Companies (Share Capital and Debentures), Rules, 2014*; but in case of **listed** shares or other specified securities should be in accordance with regulations made by the **Securities and Exchange Board of India** in this behalf.

No offer of buy-back shall be made within **one year** reckoned from the date of the closure of the preceding offer of buy back [Proviso to section 68(2)]

Free reserves includes securities premium account (Explanation II to section 68)

### Illustration – MCQ

*Buy-back with board resolution is allowed, if amount involved is*

- a. *Not exceeding twenty five percent of the total paid-up equity capital and free reserves of the company*
- b. *Not exceeding twenty five percent of the total paid-up equity capital*
- c. *Not exceeding ten percent of the total paid-up equity capital and free reserves of the company*
- d. *Not exceeding ten percent of the total paid-up equity capital*

**Answer– c [refer Section 68(2)]**

### Procedure before Buy-Back [Sub-section 3]

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.

**Rule 17(1)** of the Companies (Share Capital and Debentures), Rules, 2014 specify list of 14 matters, regarding which particulars shall be stated in explanatory statement.

### Securities to be purchased under 'Buy-Back' [Sub-section 5]

The buy-back may be from;

- a. the **existing shareholders** or security holders on a **proportionate basis**; or
- b. the **open market**; or
- c. the securities issued to **employees** of the company pursuant to a scheme of stock option or sweat equity.

### Declaration of Solvency [Sub-section 6]

A declaration of solvency has to be filed, **before** the resolution for buying back is implemented; with the Registrar and also with SEBI, if such shares of such company are listed on any stock exchange.

Declaration of solvency has to be on a Form SH-9 and verified by an **affidavit**, stating that the Board of directors has made a full inquiry into the affairs of the company and have found that it is capable of meeting all its liabilities and **will not be rendered insolvent** for a **period of 12 months** from the date of the declaration.

It has to be **signed by at least two directors** of the company, one of whom should be the **managing director**, if any.

**Example 27** – Form SH-9 filed by a listed company, Rainbow Sports Limited with registrar as well as SEBI stating Board of directors has made a full inquiry into the affairs of the company and have found that it is capable of meeting all its liabilities and will not be rendered insolvent for a period of 6 months from the date of the

declaration. Declaration was duly signed by 3 directors, none of them being MD, as MD is out of country to attend FIFA world cup event in Qatar (being one of the sponsors).

There are two lacuna in compliance to sub-section 6, first being declaration shall be for period of 12 months; secondly if managing director is appointed then he shall sign the declaration of solvency.

#### **Time limit for Completion of Buy-Back [Sub-section 4]**

Every buy-back shall be completed within **twelve months** from the date of passing the special resolution **or** board resolution authorising the buy-back.

#### **Time Check Points and Procedural aspects of Buy-Back**

The company before the buy-back of shares, file with the Registrar a **letter of offer** in Form No. SH.8, along with the fee. The letter of offer shall be dispatched to the shareholders or security holders immediately after filing the same with the Registrar of Companies but not later than **twenty days** from its filing with the Registrar of Companies.

The **offer** for buy-back **shall remain open** for a period of not less than **fifteen days** and not exceeding **thirty days** from the date of dispatch of the letter of offer, but where all members of a company agree, the offer for buy-back may remain open for a period **less than fifteen days**.

In case the number of shares or other specified securities offered by the shareholders or security holders is more than the total number of shares or securities to be bought back by the company, the acceptance per shareholder shall be on **proportionate basis** out of the total shares offered for being bought back.

The company shall **complete the verifications** of the offers received within **fifteen days from the date of closure** of the offer and the shares or other securities lodged shall be deemed to be accepted unless a **communication of rejection is made within twenty one days** from the date of closure of the offer.

The company shall **make payment within seven days of verification process** and **make payment** in cash to those shareholders or security holders whose securities have been accepted. Company will **return the share certificates** to the shareholders or security holders whose securities have not been accepted at all or the balance of securities in case of part acceptance.

**Extinguishment of Securities [Sub-section 7]**

Where a company buy's 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.

**Cooling Period – No fresh Issue [Sub-section 8]**

Where a company completes a buy-back of its shares or other specified securities, it shall not make further issue of same kind of shares or other specified securities within a period of **six months**.

It may, however, make a bonus issue and discharge its existing obligations such as conversion of warrants, stock option schemes, sweat equity or conversion of preference shares or debentures into equity shares.

**Note:** This restriction applies only to the type of securities bought back. The company is free to issue other types of security.

**Register of Buy Back [Sub-section 9]**

The company, shall maintain a register of shares or other securities which have been bought-back in Form No. SH.10 containing details of;

- a. Shares or securities so bought,
- b. Consideration paid for the shares or securities bought-back,
- c. Date of cancellation of shares or securities,
- d. Date of extinguishing and physically destroying the shares or securities and
- e. Such other particulars as may be prescribed.

**Note:**

1. This register shall be maintained at the registered office in the custody of the secretary of the company or any other person authorized by the board in this behalf.
2. The entries in the register shall be authenticated by the secretary of the company or by any other person authorized by the Board for the purpose.

### Filing of Return of Buy-back [Sub-section 10]

A return of buy-back in Form No. SH.11 along with the fee shall be filled with;

- a. The Registrar and also SEBI, if shares of company are listed on any recognised stock exchange
- b. Containing such particulars relating to the buy-back
- c. Within thirty days of such completion.

**Note:** Along with return, a certificate in Form No. SH.15 signed by two directors of the company including the managing director, if any, certifying that the buy-back of securities has been made in compliance with the provisions of the Act and the rules made thereunder.

### Penalty for Default [Sub-section 11]

If a company makes default in complying with the provisions of this section or any regulations made by Securities Exchange Board of India specified for the purposes of section 68(2)(f), the company 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 shall be punishable with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees.

### Summary of punishment

Liabe	Minimum Fine	Maximum Fine
Company	One lakh rupee	Upto three lakh rupee
Every officer of the company who is in default		

### Illustration – True and False

*Passing an ordinary resolution is sufficient where the buy-back is, not exceeding ten percent of the total paid-up equity capital and free reserves of the company.*

**Answer** - False, such buy-back has to be authorised by the Board resolution passed at its meeting.



## TRANSFER OF CERTAIN SUMS TO CAPITAL REDEMPTION RESERVE ACCOUNT [SECTION 69]

Section 69 requires certain amount to be transferred to the capital redemption reserve (CRR) account in case a company buys back its own shares.

### Amount to be transferred to CRR Account [Sub-section 1]

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
- b. Details of such transfer shall be **disclosed** in the balance sheet.

### Application of CRR Account [Section 2]

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**.

Similar use of CRR is also specified under-section 55(4) of this Act, that created when preference shares redeemed out of profit, as provided under section 55(2)(c).

### Illustration – True/False

*CRR can be used to issue partly paid bonus shares or finance discount portion of sweat equity shares.*

**Answer** - False, 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]

**Sub-section 1** states 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
  - i. repayment of deposits or interest thereon, or
  - ii. redemption of debentures, or

- iii. redemption of preference shares or
- iv. payment of dividend to any shareholder or
- v. repayment of any term loan or interest thereon to any financial institutions or banking company

**Note:**

1. Specified securities includes employees' stock option or other securities as may be notified by the Central Government from time to time (Explanation I to section 68)
2. 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.

Further **sub-section 2** prohibit the company from directly or indirectly to purchase its own shares or other specified securities in case such company has not complied with provisions of

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

**Example 28** – Sigma Electronic Limited (SEL) was financial unstable in 2018 due to economic slowdown, finally it made default in repayment of loan that it has taken from public finance corporation in June 2020 pursuant to cash crunch caused by nation-wide lock down. SEL's account was marked in defaulters list by lender and classified in NPA category. But stimulus package helped SEL to pass the high turbulence phase, it able to repay the due amount on December 2020. In February 2021 SEL account removed from NPA category. SEL won a tender in mid of 2021 and become supplier to military retail canteens. SEL accumulate reasonable amount of reserve and attain the position cash surplus. SEL decided to Buy-back 10% of its equity shares in December 2022.

Consider the facts stated in case, SEL shall not be allowed to buy-back it securities as 3 years has not been elapse since when default is remedied.



## 12. DEBENTURE [SECTIONS 71]

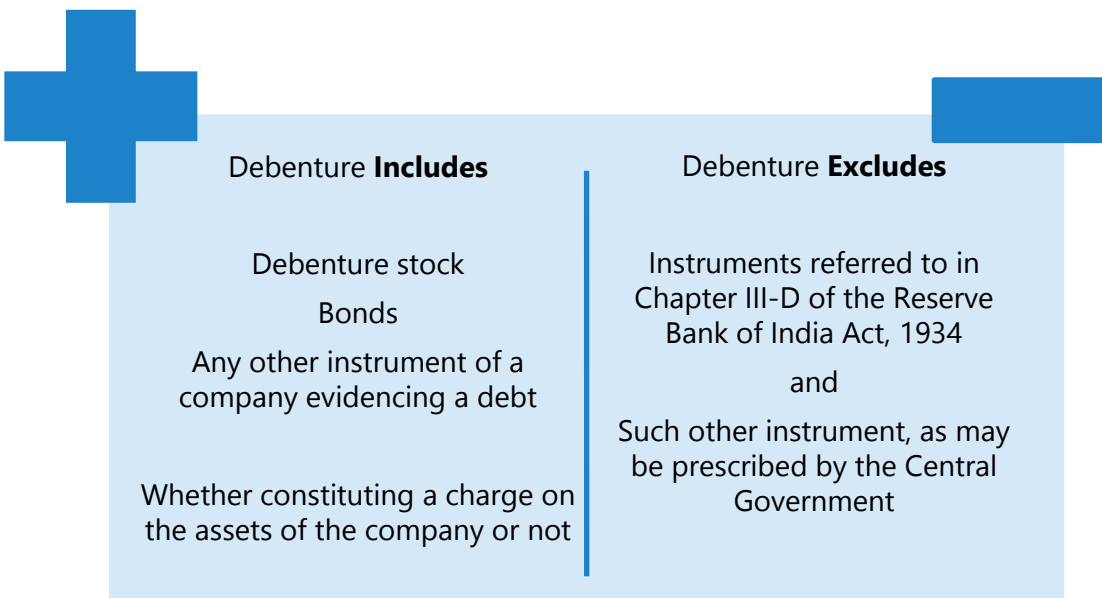
### DEFINITION AND FEATURES OF DEBENTURE

#### Definition [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 following shall not be treated as debenture

- 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,



#### Features of Debentures

- a. A debenture is the **smallest unit** of a sizeable amount of loan.
- b. When debentures are issued, the applicants are given **certificates** representing the **money they have lent** to the company.

- c. 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.
- d. The company pays **periodic interest** on the amount raised by issuing debentures till they are fully redeemed.
- e. A debenture is generally **pre-fixed with the rate of interest** which the company intends to pay.

**Example 29** - 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.

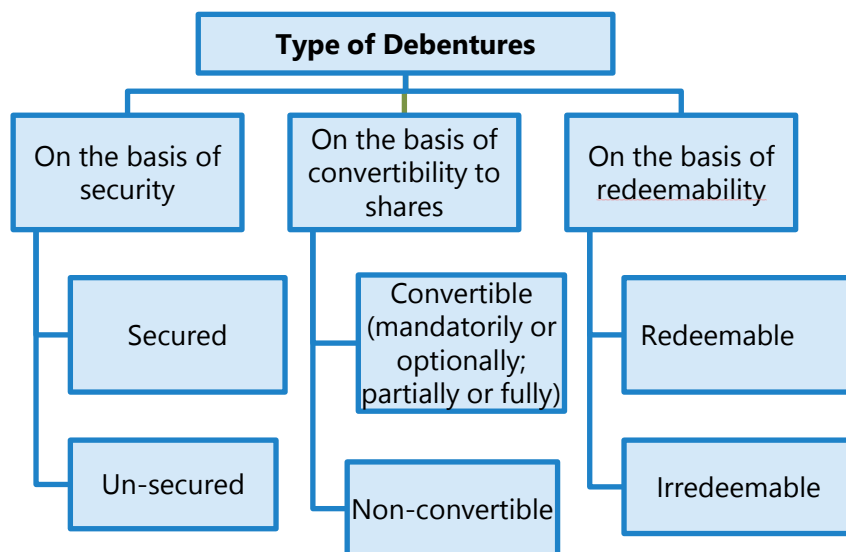
- f. **Voting rights are not available** in case of debentures as section 71 (2) of the Act, clearly states that no company shall issue any debentures carrying any voting rights.
- g. As per section 44 of the Act, a debenture is in the nature of **movable property** which is transferable as per the provisions contained in the Articles of the company issuing the debentures.
- h. 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.
- i. 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.
- j. The terms of issue may also provide for **conversion** of debentures at maturity into equity shares at the option of the debenture holders.
- k. The **debenture certificates** are required to be delivered within a period of **six months under section 56(4)(d) of the Act**, 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.

**Example 30** - 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.



## MANNER OF ISSUE OF DEBENTURES AND APPLICABLE PROVISION THERETO [SECTION 71]

### Issue of Debentures with an Option to Convert [Sub-section 1]

A company if authorised by passing special resolution at general meeting, then it may issue debentures with an **option to convert** such debentures into shares, either wholly or partly at the time of redemption.

### No Voting Rights [Sub-section 2]

No company shall issue any debentures carrying any **voting rights**.

### Issue of Secured Debentures [Sub-Section 3]

Secured debentures may be issued by a company subject to such terms and conditions as are prescribed in Rule 18 (1) of the *Companies (Share Capital and Debentures) Rules, 2014*; which are explained below;

#### a. Maximum Period of Secured Debenture

The tenor of secured debenture shall not be more than 10 years from the date of issue, except in following cases where tenor can be upto 30 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 NBFCs'** 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.

#### b. Appointment of Debenture Trustee

Debenture trustee shall be appointed by company before the issue of prospectus or letter of offer for subscription of its debentures.

#### c. Security by Creation of Charge

**Security** for the debenture can be provided by way of creating a **charge or mortgage** in **favour of debenture trustee**, on;

- i. **Specified movable** of the **company or its subsidiaries or its holding company or its associates companies, or**
- ii. **Specified immovable properties** wherever situate, or any interest therein.

**Note:**

1. Value of such assets or properties upon which charge is created shall be sufficient for the due repayment of the amount of debentures and interest thereon.
2. In case of NBFCs, the charge or mortgage may be created on any movable property.
3. In case of any issue of debentures by a **Government company** which is fully **secured by the guarantee, given by the Central Government or one or more State Government or by both**, as per the requirement for creation of charge under rule 18(1) of *the Companies (Share Capital and Debentures) Rules, 2014* shall not apply.

**d. Debenture Trust Deed**

Debenture trust deed shall be executed in Form SH-12 to protect the interest of the debenture holders, **within three months** of closure of the issue or offer.

**Creation of Debenture Redemption Reserve (DRR) Account [Sub-section 4 read with Rule 18 (7) of the Companies (Share Capital and Debentures) Rules, 2014]**

Company shall create a debenture redemption reserve (DRR) account out of the profits of the company available for payment of dividend.

The amount credited to such DRR account shall not be utilised by the company except for the redemption of debentures.

**a. Requirement of DRR**

Category	Publicly placed debenture	Privately placed debenture
All India Financial Institutions (regulated by RBI)	Exempted	Exempted
Banking Companies	Exempted	Exempted
Listed companies (other than All India Financial Institutions and Banking	Exempted except NBFCs not registered	Exempted except NBFCs not registered

Companies covered above)	with RBI u/s 45IA of RBI Act, and for House Finance companies not registered with National Housing bank	with RBI u/s 45IA of RBI Act, House Finance companies not registered with National Housing bank
Unlisted Companies (other than All India Financial Institutions and Banking Companies covered above)	DRR equal to 10% of Outstanding Debenture	DRR equal to 10% of Outstanding Debenture Except NBFCs registered with RBI u/s 45IA of RBI House Finance Companies registered with National Housing bank

**Note:**

1. The main purpose of these relaxations was introduced by the MCA for the reduction of the cost of borrowings incurred by companies.
2. Other Financial Institution covered under 2(72) of the Companies Act 2013 for purpose of creating and maintaining DRR shall be dealt in manner as Non-Banking Finance Companies registered with Reserve Bank of India
3. In case of partly convertible debentures, Debenture Redemption Reserve shall be created in respect of non-convertible portion of debenture

**b. Amount and methods of Investment or deposits for debentures maturing during the fiscal**

By 30<sup>th</sup> April of each year, the in case of;

Company	In case of
Listed Company, other than All India Financial Institutions and Banking Companies	Publicly placed debenture



Unlisted companies, other than All India Financial Institutions, Banking Companies	Publicly placed debenture & Privately placed debenture (other than those by NBFCs registered with RBI u/s 45IA of RBI and House Finance companies registered with National Housing bank)
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An amount equal to 15% of its debentures maturing during the financial year, ending on the 31st day of March of the next year, shall be invested or deposited in any of following **methods of deposits or investments**, namely;

- a. Deposits with any scheduled bank, free from any charge or lien;
- b. Unencumbered securities of the Central Government or any State Government;
- c. Unencumbered securities mentioned in sub-clause (a) to (d) and (ee) of section 20 or unencumbered bonds issued by any other company which is notified under sub-clause (f) of section 20 of the Indian Trusts Act, 1882

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. Meaning thereby that amount shall be invested or deposited by 30<sup>th</sup> April and maintained there after till end of financial year (or till maturity if fall earlier).

### Restrictions on the Issue of Prospectus/Offer/Invitation to the public [Sub-section 5]

Prior to 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, the company **shall appoint one or more debenture trustees**. Except in case of public offer of debenture, in all other cases appointment and removal of debenture trustee governed by provisions prescribed in Rule 18 (2) of the Companies (Share Capital and Debentures) Rules, 2014; namely;

#### a. Name and Consent of Denture Trustee

The **names** of the debenture trustees shall be stated in **offer related letters and notices** or subsequent thereto.

**Written consent** before the appointment of debenture trustee must be obtain and statement to that effect shall appear in the letter of offer.

**b. Who can be denture trustee?**

Following persons **shall not** be appointed as a debenture trustee,

- i. A **beneficiary holders of shares** in the company;
- ii. 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. **Relative** of any **promoter, director or key managerial personnel** of the company;
- iv. A **beneficiary entitled to moneys** which are to be paid by the company otherwise than as remuneration payable to the debenture trustee;
- v. Who is **indebted to the company**, or its **subsidiary, holding or associate** company or a **subsidiary of such holding** company;
- vi. Who has **furnished any guarantee** in respect of the principal debts secured by the debentures or interest thereon;
- vii. Who 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;

**c. Removal of debenture trustee prior to his term**

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.

**d. Filling of vacancy of debenture trustee**

Nature of vacancy	How to fill
Casual Vacancy*	Board themselves may fill any casual vacancy
Caused by the resignation	With the written consent of the majority of the debenture holders.

\*While any such vacancy continues, the remaining trustee or trustees, if any, may act till appointment made.

#### Debenture Trustee to protect Interest of Debenture Holders [Sub-section 6]

A debenture trustee shall take steps to protect the interests of the debenture-holders and redress their grievances. Duties of debenture trustee enumerated under rule 18(3) of *the Companies (Share Capital and Debentures) Rules, 2014*. Further, Rule 18 (4) of *the Companies (Share Capital and Debentures) Rules, 2014* requires debenture holders to convene the meeting of all the debenture holders on:

- a. Receiving a request (duly signed and in writing) from debenture holders holding at least one-tenth in value of the debentures
- b. Happening of any such event, which constitutes a breach, default or which in the opinion of the debenture trustees affects the interest of the debenture holders.

**Note:** Rule 18(3) and 18(4) are not applicable in case of public offer of debenture

**Example 31** – Roshan Bulb Limited took a bank loan in contravention to covenant regarding permissible debt-equity ratio, stated in offer document issued for subscription of its debentures. In this case debenture trustee bound to convene the meeting of all the debenture holder as decision of taking loan by company is not only breach but also a default that will affect the interest of the debenture holders.

#### Liability of Debenture Trustee [Sub-section 7]

Where debenture trustee **fails to show the degree of care and due diligence** required of him as a trustee.

**Any provision**, that **exempt or indemnify a debenture-trustee** from any liability for breach of trust; as contained in;

- a. A trust deed for securing the issue of debentures or
- b. Any contract with debenture holders secured by a trust deed

Shall be **void**.

**Note:** Exemptions given to debenture trustee, shall be agreed upon by debenture holders holding at least 75% value of debentures at time of meeting held for this purpose.

How to determine the reasonable degree of care and due diligence – Means a yardstick to determine failure – One have to determine in regard to the provisions of the trust deed conferring any power, authority or discretion on such debenture trustee.

**Example 32** – Debenture trustee fails in keeping a close watch on change in value of asset against which such debenture are secured, which is specified a preliminary responsibility marked upon him; it can be said debenture trustee fails to show degree of care and due diligence required of him as a trustee.

#### To pay Interest and Redeem Debentures [Sub-section 8]

A company **shall pay interest and redeem** the debentures in accordance with the **terms and conditions of their issue**.

#### Filing of Petition before Tribunal by Debenture Trustee [Sub-section 9]

Where debenture trustee reach to 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, **may file a petition** before the Tribunal.

#### The tribunal may pass order:

- a. To impose restrictions on the incurring of any further liabilities by the company as it may consider necessary in the interests of the debenture-holders.
- b. After hearing the company and any other person interested in the matter

#### Order of Tribunal on Failure to Redeem Debentures/Pay Interest [Sub-section 10]

#### Tribunal may direct by order;

- a. On the company to redeem the debentures forthwith on payment of principal and interest due thereon
- b. After hearing the parties concerned, on the application of any or all of the debenture-holders, or debenture trustee

- c. 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,

### Specific Performance of the Contract [Sub-section 12]

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.

Debenture holder has right to seek relief under the Specific Relief Act, 1963 for specific performance. Court may pass decree (in favour of debenture holder in this case) under 2(2) of the Civil Procedure Code, 1908 (CPC) and same can be executed under order 21 of CPC.

Specific performance means, forcing other party (company in this case) of contract to perform his part of contract (repayment of debenture) through court's decree.

Decree is final order passed by court as outcome of adjudication, explaining right of parties.

### Procedure to be prescribed by Central Government [Sub-section 13]

**Sub-section 13** empowers the Central Government to prescribe the:

- a. Procedure for the securing the issue of debentures,
- b. Procedure for the debenture-holders to inspect the trust deed and to obtain copies thereof
- c. Form of debenture trust deed,
- d. Quantum of debenture redemption reserve required to be created and
- e. Such other matters.

### Illustration – True/False

*If interest to debenture holder remain un-paid for two years then they may vote on resolution affecting their interests.*

**Answer** – False, no debenture holder can never assume voting right, unless their debenture is converted in equity as per terms of issue. Though similar provision exist in case of preference dividend remain unpaid for two year to preference shareholder.

**Note:**

1. **If issue results in debt-equity ratio more than 1** - In case of company other than private company, 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, then prior to the issue of debentures.

**Note** – Borrowing shall not include short term or temporary loan in nature.

2. **Pursuant to rule 12 (1) of the companies (Prospectus and allotment of securities) Rules 2014**, a company having share capital, when makes allotment of any debentures (falls within the definition of 'securities'), it is required to file a **Return of Allotment** in form No. PAS-3 within **thirty days** of such allotment with the **jurisdictional Registrar**.

## 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.
- ◆ 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 of 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. Maximum tenor of redeemable share also capped upto twenty years with exception in case infrastructure project, where it can be issued for maximum upto thirty years.
- ◆ 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 with the applicable provisions.
- ◆ Buy-back of shares is prohibited under certain circumstances.
- ◆ Debenture Redemption Reserve account is created to ring - fence funds requirement for redemption of Debentures.

## TEST YOUR KNOWLEDGE

### Multiple Choice Questions

1. *Sarvodaya Urban Nidhi Limited has ₹ 14 Crore and ₹ 6 Crore as paid-up equity and preference share capital respectively. Balance in retain earnings account is ₹ 2.4 Crore. Equity share capital having face value of ₹ 10 each, while preference share has face value of 100 each. Mr. Surya and Mr. Chandan own 11,20,000 and 5,60,000 shares respectively. In context of resolution placed before the company which directly affect the rights attached to his preference shares, the voting right of Mr. Surya and Mr. Chandan in percentage term shall be:*
  - (a) 8% and 4% respectively
  - (b) 5.6% and 2.8% respectively

- (c) 5% and 2.8% respectively
  - (d) 5% and 2.5% respectively
2. *In a litigation regarding title of shares, a share certificate issued in physical form by Modern Furniture Limited, an unlisted private company that doesn't have a common seal submitted as evidence of the title. The same shall be clear and convincing evidence of title, if signed by;*
- i. *two directors*
  - ii. *two directors, out of which one shall be managing director*
  - iii. *two directors and the Company Secretary, wherever the company has appointed a Company Secretary*
  - iv. *a director and the Company Secretary, wherever the company has appointed a Company Secretary*
- (a) *By i or iii only*
  - (b) *By i or iv only*
  - (c) *By ii or iii only*
  - (d) *By ii or iv only*
3. *Mr. Bahu has received a notice from Mahishmati Private Limited on 2<sup>nd</sup> March, 2023 intimating that Mr. Bali has submitted a transfer deed duly signed by him for transfer of 1000 partly paid shares (₹ 8 paid-up out of Face Value of ₹ 10 per share) in his (Mr. Bahu) name. Mr. Bahu as transferee must raise his objection to the proposed transfer of partly paid shares latest by*
- (a) *9<sup>th</sup> March, 2023*
  - (b) *16<sup>th</sup> March, 2023*
  - (c) *17<sup>th</sup> March, 2023*
  - (d) *31<sup>st</sup> March, 2023*
4. *Section 67 of the Companies Act, 2013 impose a restriction on public company from giving any financial assistance whether directly or indirectly and whether by means of a loan, guarantee, the provision of security or otherwise 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. Star Engineering Limited which is not covered by any of exemptions specified under*



said section, contravene the restrictive provisions stated above. Every officer of the company who is in default shall be liable for;

- (a) *Fine which shall not be less than one lakh rupees but may extend to twenty-five lakh rupees*
  - (b) *Fine which shall not be less than one lakh rupees but may extend to twenty-five lakh rupees or Imprisonment for a term which may extend to three years or both*
  - (c) *Fine which may extend to twenty-five lakh rupees or Imprisonment for a term which may extend to three years or both*
  - (d) *Fine which shall not be less than one lakh rupees but may extend to twenty-five lakh rupees and Imprisonment for a term which may extend to three years*
5. *Modern Furniture an unlisted company receive a request for issue of duplicate share certificate. Complete documents in this regards submitted with the company on 30<sup>th</sup> December 2022. Modern furniture shall issue the duplicate share certificates by:*
- (a) *29<sup>th</sup> January 2023*
  - (b) *13<sup>th</sup> February 2023*
  - (c) *28<sup>th</sup> February 2023*
  - (d) *29<sup>th</sup> March 2023*

## Descriptive Questions

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. provided 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.*

- 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.*
- 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. Is there any liability of company and officer in default in the said matter?*
- 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?*
- 5. Trisha Data Security Limited was incorporated just a year ago with a paid-up share capital of ₹ 200 crore. Within such a small period of about 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.*
- 6. Walnut Foods Limited has an authorized share capital of 2,00,000 equity shares of ₹ 100 per share and an amount of ₹ 2 crore 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.*

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.*
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*
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?*
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?*
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.*

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.*

## ANSWERS

### Answer to MCQ based Questions

1.	(c) 5% and 2.8% respectively
2.	(b) two directors, out of which one shall be managing director
3.	(c) 16 <sup>th</sup> March, 2023
4.	(d) Fine which shall not be less than one lakh rupees but may extend to twenty-five lakh rupees and Imprisonment for a term which may extend to three years
5.	(d) 29 <sup>th</sup> March 2023

### Answer to Descriptive Questions

1. 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.

**2. 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 Form No. SH-7 as per Rule 15 of *the Companies (Share Capital and Debentures) Rules, 2014* with the **Registrar**, along with an **altered memorandum** within **thirty days of alteration**. 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.

3. 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.

4. 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.

**5. 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 any difference that the company is just about a year old, because there is no such age (time since commencement of business) requirement under Section 54.

**6. 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.

**7. 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**.
- 8.** 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.

- 9. 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.

- 10.** 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.

11. 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.

- 12.** 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.

[illegible]

