UNIT 4: Share Capital and Debenture

Semester-Semester-II
Subject- Company Law
Topic-Share Capital and Debenture

Share Capital and Debenture:

A share is the interest of a member in a company. Section 2(84) of the Companies Act, 2013 "share" means a share in the share capital of a company and includes stock.

As per **Section 44 of the Companies Act, 2013** the shares or debentures or other interest of any member in a company shall be **movable property and transferable** in the manner provided by the articles of the company.

Nominal or Authorized or Registered Capital

Section 2(8) of the Companies Act, 2013, defines Nominal Capital as the amount of capital that the Memorandum of the company authorizes as the share capital of the company.It is mentioned in the capital clause of the Memorandum of Association Section 4(1)(e)(i) of Companies Act 2013. This capital is known as Registered Capital and a company cannot issue shares more than this amount.

Section 2(8) of The Companies Act 2013 defines that Authorised capital or Nominal capital means such capital as is authorised by the memorandum of association (MOA) of a company to be the maximum amount of share capital of the company.

Issued Capital:

As per Section 2(50) "issued capital" means such capital as the company issues from time to time for subscription.

Out of the authorised Capital the amount of share capital which is issued to the public for subscription is called Issued Capital. Further, it is mandatory for companies to disclose its issued capital in the balance sheet (Schedule III of the Act).

Subscribed Capital:

As per Section 2(86) of the Companies Act, 2013, "Subscribed Capital" means such part of the capital which is for the time being subscribed by the members of a company.

So, the part of the issued capital for which applications are sent by the public and which are accepted is called Subscribed Capital.

<u>Called-up Capital:</u>

According to Section 2(15) of the Companies Act, 2013, Called up Capital is the part of the capital which the company calls for payment.So, Called-up Capital means such part of the capital, which has been called for payment.

<u>Paid-up Capital:</u>

As per Section 2(64) "paid-up share capital" or "share capital paid-up" means such aggregate amount of money credited as paid-up as is equivalent to the amount received as paid-up in respect of shares issued and also includes any amount credited as paid-up in respect of shares of the company, but does not include any other amount received in respect of such shares, by whatever name called.

Paid up capital = Called up capital – Calls in Arrears.

<u>Net Worth:</u>

As per Section 2 (57) of Companies Act 2013, "net worth" means the aggregate value of the paid-up share capital and all reserves created out of the profits and securities premium account, after deducting the aggregate value of the accumulated losses, deferred expenditure and miscellaneous expenditure not written off, as per the audited balance sheet, but does not include reserves created out of revaluation of assets, write-back of depreciation and amalgamation.

<u>TYPES OF SHARE CAPITAL</u>

<u>A. *Equity Share Capital:*</u>

Section 43 of the Act provides that the share capital of a company limited by shares shall be of two kinds:

<u>(a) Equity share capital:</u>(''Equity share capital'', with reference to any company limited by shares, means all share capital which is not preference share capital.)

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

(b) Preference share capital

Equity shares:

As per section 47 (1) EquityShareholders enjoy voting rights

Subject to the provisions of section 43, sub-section (2) of section 50 --

(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.

According to RULE 4 of the Companies (Share Capital and Debentures) Rules 2014 as prescribed for Equity Shares with differential rights are as follows:

Procedure for issuing Equity Shares with differential rights :

No company whether it is unlisted, listed or a public company limited by shares shall issue equity shares with differential rights as to dividend, voting or otherwise, unless it complies with the following conditions:

a) the articles of association of the company authorizes the issue of shares with differential rights.
b) the issue of shares is authorized by an ordinary resolution passed at a general meeting of the shareholders Provided that where the equity shares of a company are listed on a recognized stock exchange, the issue of such shares shall be approved by the shareholders through postal Ballot.
c) the shares with differential rights shall not exceed twenty six percent of the total post-issue paid up equity share capital including equity shares with differential rights issued at any point of time.
d) the company having consistent track record of distributable profits for the last three years.
e) the company has not defaulted in filing financial statements and annual return for three financial years immediately preceding the financial year in which it is decided to issue such shares.

f) the company has no subsisting default in the payment of a declared dividend to its shareholders or repayment of its matured deposits or redemption of its preference shares or debentures, that have become due for redemption or payment of interest on such deposits or debentures or payment of dividend.
g) the company has not defaulted in payment of the dividend on preference shares or repayment of any term loan from a public financial institution or State level financial institution or scheduled Bank that has become repayable or interest payable thereon or dues with respect to statutory payments relating to its employees to any authority or default in crediting the amount in Investor Education and Protection Fund to the Central Government.
h) the company has not been penalized by Court or Tribunal during the last three years for any offence under the Reserve Bank of India Act, 1934 , the Securities and Exchange Board of India Act, 1992, the Securities Contract Regulation Act, 1956, the Foreign Exchange Management Act, 1999 or any other special Act, under which such companies being regulated by sectoral regulators.

Details disclosure in explanatory statement:

The explanatory statement to be annexed to the notice of the general meeting to be convened pursuant to section 102 or of a postal ballot pursuant to section 110 shall contain the following particulars:

a) the total number of shares to be issued with differential rights;
b) the details of the differential rights;
c) the percentage of the shares with differential rights to the total post issue paid up equity share capital including equity shares with differential rights issued at any point of time;
d) the reasons or justification for the issue;
e) the price at which such shares are proposed to be issued either at par or at premium;
f) the basis on which the price has been arrived at
g) (i) **in case of private placement or preferential issue**–
    a. details of total number of shares proposed to be allotted to promoters, Directors and key managerial personnel;
    b. details of total number of shares proposed to be allotted to persons other than promoters, directors and key managerial personnel and their relationship if any with any promoter, director or key managerial personnel;

(ii) **in case of public issue -** reservation, if any, for different classes of applicants including promoters, directors or key managerial personnel;

h) the percentage of voting right which the equity share capital with differential voting right shall carry to the total voting right of the aggregate equity share capital;

i) the scale or proportion in which the voting rights of such class or type of shares shall vary;

j) the change in control, if any, in the company that may occur consequent to the issue of equity shares with differential voting rights;

k) the diluted Earning Per Share pursuant to the issue of such shares, calculated in accordance with the applicable accounting standards;

l) the pre and post issue shareholding pattern along with voting rights as per clause 35 of the listing agreement issued by Security Exchange Board of India from time to time.

- The company shall not convert its existing equity share capital with voting rights into equity share capital carrying differential voting rights and vice–versa.
- The Board of Director shall disclose in the Board's Report for the financial year in which the issue of equity shares with differential rights wascompleted, such as-

  (a) total number of shares allotted with differential rights;

  (b) details of the differential rights relating to voting rights and dividends;

  (c) the percentage of the shares with differential rights to the total post issue equity share capital with differential rights issued at any point of time and percentage of voting rights which the equity share capital with differential voting right shall carry to the total voting right of the aggregate equity share capital;

  (d)the price at which such shares have been issued;

  (e) the particulars of promoters, directors or key managerial personnel to whom such shares are issued;

  (f) the change in control, if any, in the company consequent to the issue of equity shares with differential voting rights;

  (g)the diluted Earning Per Share pursuant to the issue of such each class of shares, calculated in accordance with the applicable accounting standards;

(h)the pre and post issue shareholding pattern along with voting rights in the specified format under sub-rule (2) of rule 4.

- The holders of the equity shares with differential rights shall enjoy all other rights such as bonus shares, rights shares etc., which the holders of equity shares are entitled to, subject to the differential rights with which such shares have been issued.
- In case a company issuing equity shares with differential rights, the Register of Members maintained under Section 88 shall contains all the relevant particulars of the shares so issued along-with details of the shareholders.

B. Preference Share Capital

As per explanation given in the Section 42 of the Companies Act, 2013, the term preference shares includes the part of share capital to which the holders have a preferential right during payment of dividend and repayment of share capital in the event of company liquidation.

Types of Preference Shares:

- *On the basis of Right to Dividend: Cumulative and Non-Cumulative Preference Shares*

- *On the basis of Convertibility: Convertible and Non-convertible Preference Shares*

- On the basis of Maturity Period: Redeemable and Irredeemable Preference Shares
- On the basis of participation in surplus profits- Participating and Non –Participating Preference Shares

Issue and Redemption of Preference Shares:

As per Section 55(1) :No company limited by shares shall, after the commencement of this Act, issue any preference shares which are irredeemable.

As per Section 55(2)

A company limited by shares may, if so authorised by its articles, issue preference shares which are liable to be redeemed within a period not exceeding twenty years from the date of their issue subject to such conditions as may be prescribed, stated that a company may issue preference shares for a period exceeding 20 years for infrastructure projects, subject to the redemption of such percentage of shares as may be prescribed on an annual basis at the option of such preferential shareholders.

Conditions for redemption:

Preference shares can be redeemed under following conditions:

- Redemption can be made in any of the two procedures i.e. either out of the profits of the company which would otherwise be available for dividend; or; out of the proceeds of a fresh issue of shares made for the purposes of such redemption.
- No such shares shall be redeemed unless they are fully paid up.
- In case the company proposes redemption of shares out of the profits of the company, there shall, out of such profits, be transferred, a sum equal to the nominal amount of the shares to be redeemed, to a reserve, to be called the Capital Redemption Reserve 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 Capital Redemption Reserve Account were paid-up share capital of the company. This 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.
- In case of such class of companies, as may be prescribed and whose financial statements 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.

Issue and redemption of Preference Shares by Company in infrastructural projects (Rule 10):

Issue and redemption of preference shares by company in infrastructural projects.- A company engaged in the setting up and dealing with of infrastructural projects may issue preference shares for a period exceeding twenty years but not exceeding thirty years, subject to the redemption of a minimum ten percent of such preference shares per year from the twenty first year onwards or earlier, on proportionate basis, at the option of the preference shareholders.

Bonus Shares: Section 63

Bonus shares are accumulated profits that a company distributes to the existingshareholders free of charge as free shares.

Issue of Bonus Shares(Capitalisation of reserve by issuing shares to its existing shareholders at free of cost on a prorata basis to increase Paid –up share capital with the issue of Bonus Shares)

As per Section 63(1), a company may issue fully paid-up bonus shares to its members, out of—

(i) Its free reserves;

(ii) The securities premium account; or

(iii) The capital redemption reserve account: The section specifically clarifies that no issue of bonus shares shall be made by capitalising reserves created by the revaluation of assets.

***Conditions for issue*:** No company shall capitalise its profits or reserves for the purpose of issue of fully paid-up bonus shares under sub-section (1) unless —

a) It is authorised by its articles;
b) It has, on the recommendation of the Board, been authorised in the general meeting of the company;
c) It has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it;
d) It has not defaulted in respect of the payment of statutory dues of the employees, such as, contribution to provident fund, gratuity and bonus;
e) The partly paid-up shares, if any outstanding on the date of allotment, are made fully paid-up;
f) It complies with such conditions as may be prescribed.

- As per Section 63(3) ,the bonus shares shall not be issued in lieu of dividend.
- As per Rule-14, the company which has once announced the decision of a bonus issue on the recommendation of its Board, can not subsequently withdraw the same.
- Under Section 2(43) "free reserves" means such reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend:
- **Provided** that—
- (*i*) any amount representing unrealised gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or
- (*ii*) any change in carrying amount of an asset or of a liability recognized in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value, shall not be treated as free reserves.

Employees Stock Option Plan(ESOP) Or Employees Stock Scheme(ESOS) :

Section 2(37) of the Companies Act, 2013 defines employees stock option as the option given to the directors, employees or officers of the company or of its holding 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 predetermined price on a future date.

The objectives of issuing ESOP are to:

- Provide incentive to attract, retain and reward employees of the company.
- Motivate employees to contribute to the growth and profitability of the company.

Rule 12 of the (Share Capital and Debentures) Rules, 2014

Rule 12(1) defines "Employee" as:

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

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

c) an employee as defined in clauses (a) or (b) of a subsidiary, in India or outside India, or of a holding company of the company or of an associate company.

As per Rule 12(c), the following are not included in the definition of an Employee and therefore ESOPs cannot be issued to the following:

1. an employee who is a promoter or a person belonging to the promoter group; or
2. a director who either himself or through his relative or through anybody corporate, directly or indirectly, holds more than 10% of the outstanding equity shares of the company.

- **Buy Back of Shares(Section 68):**
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- **Buy-Back permits a company as a tool for financial-re-engineering, to purchase or buy back its shares from the existing shareholders when the company is having sufficient cash balance and finds that the market rate of securities is much lower than the face value .**

Sources of Buy-back:-

The buy-back of shares can be made only out of: (a) Free Reserves (means reserves as per the last audited Balance Sheet which are available for distribution and share premium but not the share application amount)

(b) Securities Premium Account

(c) Proceeds of any shares or other specified Securities provided that no buy back of any kind of shares or other specified securities shall be made out of proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.

As per the Provision of Companies Act, 2013, No company shall purchase its own shares or other specified securities under sub-section (1), unless—

(a) The buy-back is authorized by its articles;

(b) A special resolution has been passed at a general meeting of the company authorizing the buy-back. Provided that nothing contained in this clause shall apply to a case where— (i) The buy-back is, ten per cent or less of the total paid-up equity capital and free reserves of the company; and (ii) Such buy-back has been authorized by the Board by means of a resolution passed at its meeting;

(c) The buy-back is twenty-five per cent. Or less of the aggregate of paid-up capital and free reserves of the company: Provided that in respect of the buy-back of equity shares in any financial year, the reference to twenty-five per cent. In this clause shall be construed with respect to its total paid-up equity capital in that financial year;

(d) The ratio of the aggregate of secured and unsecured debts owed by the company after buy-back is not more than twice the paid-up capital and its free reserves: Provided that the Central Government may, by order, notify a higher ratio of the debt to capital and free reserves for a class or classes of companies;

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

(f) The buy-back of the shares or other specified securities listed on any recognized stock exchange is in accordance with the regulations made by the Securities and Exchange Board in this behalf; and

(g) The buy-back in respect of shares or other specified securities other than those specified in clause (f) Is in accordance with such rules as may be prescribed: Provided that no offer of buy-back under this sub-section shall be made within a period of one year reckoned from the date of the closure of the preceding offer of buy-back, if any.

Sweat Equity Shares(Section 54):

According to Section 2(88)Sweat equity shares means such equity shares as are issued by a company to its director 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.

Right Issue(Section 62):

As per **Section 62(1)** Where at any time, a Company having a share capital proposes to increase its subscribed capital by the issue of further shares, such shares shall be offered to persons who, at the date of the offer, are holders of equity shares of the company in proportion, as nearly as circumstances admit, to the paid-up share capital on those shares by sending a letter of offer.

Important conditions:

1. The offer shall be made by notice specifying the number of shares offered and limiting a time not being less than fifteen days and not exceeding thirty days from the date of the offer within which the offer, if not accepted, shall be deemed to have been declined. **[Section 62(1)(a)(i)]**
2. Unless the Articles of the Company otherwise provide, the offer of Right Issue of Shares shall be deemed to include a right exercisable by the person concerned to renounce the shares offered to him or any of them in favour of any other person and the notice shall contain a statement of this right. **[Section 62(1)(a)(ii)]**
3. After the expiry of the time specified in the notice aforesaid, or on receipt of earlier intimation from the person to whom such notice is given that he declines to accept the shares offered, the Board of Directors may dispose of them in such manner which is not dis-advantageous to the shareholders and the company. **[Section 62(1)(a)(iii)]**

Issue of shares at premium(Section 52):

When shares are issued by a company **at a price higher than the face value**, they are said to be issued at a premium. Thus, the excess of issue price over the face value is the amount of premium.

The application of securities premium account (As per Section 52(2) of the Companies Act,2013) are as follows:

- In writing off the preliminary expenses of the company;
- For writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debenture of the company;
- Issue of fully paid Bonus shares to the members of the Company
- Premium payable on the redemption of any redeemable preference shares
- For Buy back of its own shares and other securities as per Section 68.

Provision as per Companies Act:

Notwithstanding anything contained in sub-section (1), 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 debenture 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, notwithstanding anything contained in sub-sections (1) and (2), 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.

<u>Debenture</u>

As per Section 2(30) of Companies Act, 2013 “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.

<u>Procedure to issue Debentures under Section 71 of Companies Act, 2013</u>

(1) A company may issue debenture with an option to convert such debentures into shares , either wholly or partly at the time of redemption:

Provided that the issue of debentures with an option to convert such debentures into shares, wholly or partly, shall be approved by a special resolution passed at a general meeting.

(2) No company shall issue any debentures carrying any voting rights .

(3) Secured debentures may be issued by a company subject to such terms and conditions as may be prescribed.

(4) Where debentures are issued by a company under this section, the company shall create a debenture redemption reserve account out of the profits of the company available for payment of dividend and the amount credited to such account shall not be utilized by the company except for the redemption of debentures.

(5) No company shall issue a prospectus or make an offer or invitation to the public or to its members exceeding five hundred for the subscription of its debentures, unless the company has, before such issue or offer, appointed one or more debenture trustees and the conditions governing the appointment of such trustees shall be such as may be prescribed.

(6) A debenture trustee shall take steps to protect the interests of the debenture-holders and redress their grievances in accordance with such rules as may be prescribed.

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

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

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

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

(10) Where a company fails to redeem the debentures on the date of their maturity or fails to pay interest on the debentures when it is due, the Tribunal may, on the application of any or all of the debenture-holders, or debenture trustee and, after hearing the parties concerned, direct, by order, the company to redeem the debentures forthwith on payment of principal and interest due thereon.

(11) A contract with the company to take up and pay for any debentures of the company may be enforced by a decree for specific performance.

(12) The Central Government may prescribe the procedure, for securing the issue of debentures, the form of debenture trust deed, the procedure for the debenture-holders to inspect the trust deed and to obtain copies thereof, quantum of debenture redemption reserve required to be created and such other matters.

References:

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2. **“Company Law” by Udayan Ray Chowdhury, Supriya Bhattacharjee, Sarada Prasad Dutta**
3. **“An Introduction to company Law” with The Companies(Amendment) Act,2017 by Biswajit Paul, Pinaki Ghosh**