

Unit 4: SHARE CAPITAL & DEBENTURE [No of classes 16 / Marks 16]

Share, Share Capital - Types and Definition, Allotment and Forfeiture, Calls on Shares, ESOP, Buyback, Sweat Equity, Bonus, Right, Capital Reduction, Share Certificate, D-mat System, Transfer and Transmission, Redemption of Preference Shares, Debenture – Definition, Types, Rules Regarding Issue of Debenture.

SHARE

U/s 2(84) share means share in the share capital of the company and includes stock. Therefore share means a unit into which the Share Capital of the company is divided.

A share is the interest of the shareholder in the company measured by a sum of money for the purpose of liability in the first place and dividend in the second as given by Justice Farewell.

In the CIT vs. Standard Vaccum Oil Co the judge opined that “by a share in a company is meant not any sum of money but a interest measured by a sum of money and made up of diverse rights conferred on its holders by the articles of the company which constitute a contract between them and the company”.

SHARE CAPITAL

Share Capital means funds raised by companies by issue of shares.

Different types on the basis of rights:

Equity Shares: Those shares which are not Preference Shares are equity shares, equity shares are having voting rights and are the actual owners of the company.

TYPES OF EQUITY SHARES:

Public Issue:

Initial Public Offer[IPO]; Financial Public Offer[FPO];

Private Issue:

Right Shares;

Bonus Shares;

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Institutional investors

PREFERENCE SHARES:

Preference Shares: Preference Shares are those shares which have preferential rights regarding dividend and refund of capital. They get fixed dividend.

TYPES OF PREFERENCE SHARES:

- Cumulative Preference Shares
- Non Cumulative Preference Shares

- Participating Preference Shares
- Non Participating Preference Shares

- Convertible Preference Shares
- Non Convertible Preference Shares

- Redeemable Preference Shares
- Irredeemable Preference Shares

- Deemed Preference Shares [Sec 43]: By whatever name it is called if the shares have the rights of preference shares then it is called Deemed Preference Shares.

DIFFERENT TYPES ON THE BASIS OF CALLED UP CAPITAL :

- **Authorised Share Capital**
Total value of shares the company is allowed to allot. Authorized capital is mentioned in the capital clause of the memorandum – It is also known as nominal or registered capital.

- **Allotted Share Capital**
Value of shares the company has actually allotted to members.

- **Paid-up Share Capital**
Amount that members have paid on their shares, excluding any premium.

- **Called-up Share Capital**
Paid-up capital + any amount members have been called on to pay.

- **Uncalled Capital**
Uncalled capital is the amount owing on partly paid shares which members have not yet been called on to pay.

- **Reserve Capital**
Reserve capital is uncalled capital the company has resolved not to call unless the company is wound up.

- **Capital Reserve**
That portion of Authorized capital which is still not called.

ALLOTMENT OF SHARES

Allotment is the acceptance of a Company to give Shares to the Investor in response to an offer for purchase of Shares made by him for a consideration. Allotment has not been defined Companies Act 2013. It is construed to mean the act of allotting.

The investing public makes its offer to subscribe for Shares in Application Forms [prospectus] supplied by the Company. When the Company accepts an application, it amounts to allotment by the company. Some definitions by judicial decisions are given below:

1. Allotment is "The appropriation out of the previously unappropriated Capital of the Company, of a certain number of Shares to a person --- Sri Gopal Jalan & Co. vs Calcutta Stock Exchange Association Ltd." (1964)

Re-issue of forfeited Shares does not constitute appropriation out of the Unappropriated Capital of the Company, hence it is not allotment.

The procedure involved in Allotment:

The procedure of Allotment of Shares

1. Resolution by Board of Directors/Committee should be passed.
2. Allotment Letter: Upon allotment, the Company should send/post an Allotment Letter to each of the allottees mentioning therein the details of Shares allotted to them.
3. Return of Allotment: The Company should file a Return of Allotment in FORM PAS -3, with the ROC along with fee, within 30 days from the date of allotment. The time limit can be extended by the ROC on an application made by the Company.
4. Register of members: The Company should prepare Register of members in accordance with section 88.
5. Share Certificate: instead of Share Certificate now the person who has been allotted can see his holding in the demat account.

FORFEITURE OF SHARES

If a member fails to pay a valid call within the stipulated time, the company may sue him for recovery of the amounts of the call after waiting for a reasonable period. But articles often provide for forfeiture of shares for non-payments of any call or installment of a call.

The power of forfeiture must be exercised bonafide and in the interest of the Company. It should not be collusive or fraudulent.

- When forfeiture takes place, share holder ceases to be a member.
- Schedule 1, Clause 32 further provides that the liability of a person whose shares have been forfeited ceases.
- Forfeited shares become the property of the Company To this extent forfeiture involves a reduction in the paid up capital till the shares are re-issued.

- A Company can re-issue forfeited shares at any price even at discount provided the total of the sum paid by the original owner of the shares together with the re-issue price is not less than the par value.
- Articles to Authorise: Shares can be forfeited for non-payment of any call, if the articles authorise as per Regulation 28 of Table F.
- Resolution of forfeiture: Articles Regulation 30 of the table F provides that if the defaulting shareholders do not pay the amount within the specified time as required by the notice the directors may pass a resolution forfeiting the shares, otherwise it will be invalid.
- Proper Notice: Before the shares of a member are forfeited, a proper notice to that effect must have been served

CALLS ON SHARES

After the receipt of application and allotment moneys, the company is to collect the balance unpaid on the shares allotted in accordance with the terms of issue. The unpaid balance called in at once by making first call only. It will then be known as first and final call. In case call money is collected in more than one installment, further installments are known as second call, third call and so on. The words 'and final call' have to be added to the last installment e.g, second and final call or third and final call as the case may be.

- Call refers to the demand for Share Money other than those by way of application and allotment.
- Money payable on call is part of the issue price of Shares/Debentures, which has not yet been paid and the payment date is not specified in the terms of issue.
- Power to make calls vests with the Board of Directors vide a Resolution in its Meeting.
- Call may be at any time- during the lifetime of the Company, or during its winding up.
- A Shareholder is bound to pay the full amount of his Calls.
- Non-payment of Calls within the specified time will render the Shareholder liable for interest as per the AOA. [Table F provides for a maximum of 10% Interest p.a.]

CALLS IN ADVANCE

- Authorised by AOA:AOA should authorize the Company to accept money remaining unpaid on the shares, irrespective of calls not made by the Company.
- Acceptance of Calls in Advance: The Company can accept the whole or a part of the amount remaining unpaid on any Shares held by a Member, even if no calls are made.
- Interest: The Company can pay interest at a rate agreed upon between the Board and Members paying the sum. Table F provides for a maximum rate of 12% p.a.

- Not Refundable: The amount received in advance of calls is not refundable.
- Priority: In the event of winding up the Shareholder ranks after the Creditors, but in Advance must be paid along with the interest, if any before, the other Shareholders are paid of.
- Duly exercised Power: The power to receive the Calls-in-Advance, must be exercised in the general interest and for the benefit of the Company.

SWEAT EQUITY SHARES

Sweat equity shares' are such equity shares, which 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.

Sweat equity shares is one of the modes of making share based payments to employees of the company. The issue of sweat equity shares allows the company to retain the employees by rewarding them for their services. Sweat equity shares rewards the beneficiaries by giving them incentives in lieu of their contribution towards the development of the company.

- The issue is authorised by a special resolution passed by the company;
- 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;
- 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 rules.
- The expressions "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

EMPLOYEE STOCK OPTION PLAN (ESOP)

The term Employee Stock Option Plan (ESOP) has been defined under section 2(37) of the Companies Act 2013.

Definition as per companies Act 2013 : u/s 2(37) "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 pre-determined price. ESOP also known as Employee stock option scheme (ESOS) or Employee Stock Purchase Scheme (ESPS). SEBI has issued guidelines about ESOP, according to which Employee Stock Option Scheme means a right but not an obligation granted to all permanent employee in the pursuance of ESOP to apply for shares of the company at a pre-determined price.

Rule 12 of the Companies (Share Capital and Debentures) Rules, 2014 with respect to ESOP are given below

- The issue of ESOP would be subject to approval by shareholders through a special resolution.
- The option is not transferable to any person and no one other than employee can exercise the option.
- A minimum period of one year between grant of option and its vesting has been prescribed.
- After one year, the period during which the option can be exercised would be determined by the company.
- The employee shall not have the right of dividend or vote till they exercise the option and shares are issued to them.
- The amount ,if any payable by the employees at the time of grant of option may be forfeited or may be refunded if the option is not exercised by the employee.
- A company, other than a listed company, which is not required to comply with Securities and Exchange Board of India Employee Stock Option Scheme Guidelines shall not offer shares to its employees under a scheme of employees' stock option (hereinafter referred to as "Employees Stock Option Scheme'), unless it complies with the certain requirements.
- The company shall maintain a register regarding ESOP[ESOS}in the registered office indicating the options granted, option vested, option exercised.

BUY BACK OF SHARES (SECTION 68)

The Companies Act 2013 has introduced Section 68 which permits a company to purchase or buy back its own shares or other securities as per the following conditions:

(a)Such buy back should be out of the following u/s 68(1)

1. Free reserve.
2. Securities Premium Account.
3. 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 the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities

NOTE:25% WILL BE THE MAXIMUM BUY BACK OF THE AGGRATE OF PAID UP CAPITAL AND FREE RESERVE OF THE COMPANY

Such buy back should follow the following procedures u/s 68(2):

1. Such buy back has been authorised by the Board by means of resolution passed.
2. The buy-back of the securities should be authorised by the Company Articles and also by the company by a special resolution passed in the general meeting.
3. Every buy back should be completed within twelve months from the date of passing the special resolution.
4. Company shall after the completion of the buy-back file with the Registrar and SEBI within 30 days of such completion.
5. Where a company buys back its own securities, it shall extinguish and physically destroy the securities so bought back within 7 days of the last date of completion of buy back.
6. Where a company purchases it's own shares out of free reserves a sum equal to nominal value of shares so purchased shall be transferred to capital redemption reserve. The details of such transfer shall also be disclosed in the Balance Sheet.

7. No fresh issue after buy back for a period of 6 months.

Prohibition for buy back in certain circumstances u/s 70[1]

1. No company shall directly or indirectly purchase its own shares or other specified securities
 - (a) through any subsidiary company including its own subsidiary companies;
 - (b) through any investment company or group of investment companies; or
 - (c) if a default, is made by the company, in the repayment of deposits accepted either before or after the commencement of this Act, interest payment thereon, redemption of debentures or preference shares or payment of dividend to any shareholder, or repayment of any term loan or interest payable thereon to any financial institution or banking company:

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

MERITS OF BUY-BACK

Buy-back of equity share offers the following advantages or benefits to the company:

- i. The company can use its surplus cash which is lying unutilised and there are no proper investment opportunities.
- ii. It improves the return on capital (ROC), net profitability and also earning per share.
- iii. It enables the settlement with dissatisfied or dissenting members of the company.
- iv. It enables the company to buy the shares of the retiring employees.
- v. The existing promoters or managements can keep their control over the company because of less shares available for sale in the market.
- vi. The remaining shareholders are kept happy because of more amount of dividend and company's market value of shares increases.
- vii. It brings liquidity in the hands of the investors.
- viii. It rationalises the capital structure of the company.

DEMERITS OF BUY-BACK

It is feared that the buy-back may be misused by the corporate entities at the cost or innocent investors. The inherent dangers may be listed as:

- i. It will provide an ample opportunity for inside trading. The promoters, before the buy-back, may understate the earnings by manipulating accounting policies, say, in respect of depreciation, valuation of inventories etc. This would lead to a fall in the quoted prices of shares and the promoters would buy them at low quotations. In this manner, the insiders would make extra money when the company buys-back these shares at a higher price.

- ii. Buy-back may lead to artificial manipulations of stock prices.
- iii. The position of the minority shareholders is weakened as buy-back enables the management to increase their control over the company.

BONUS SHARES SECTION -63

All successful companies increase their capital base by giving free shares to its existing shareholders from the reserves, when there are large accumulated reserves which cannot, either by law or as a matter of financial prudence, be distributed as dividends in cash to shareholders. In other words, a firm may retain a large part of its earnings for reinvestment purposes, pay less in the form of cash dividend and yet provide better shareholder return by way of issue of bonus share, Since bonus shares are created by the conversion of retained earnings or other reserves into equity share capital, issue of bonus shares does not represent a source of fund to the company.

A company may if its Articles provide **capitalise its profit** by issuing fully paid bonus shares.

The bonus shares allotted to the members do not represent taxable income in their hands.

Provision as per Companies Act 2013 [New Provision]:

In the Section 63 (1) A company may Issue fully paid-up bonus shares to its members, in any manner whatsoever, out of-

- (i) its free reserves [Note];
- (ii) the securities premium account
- (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.

(2) No company shall capitalise its profits or reserves for the purpose of issuing fully paid-up bonus shares under sub-section (i), 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.

(3) The bonus shares shall not be issued in lieu of dividend. According to Rule 14 of The Companies (Share Capital and Debentures) Rules 2014-

The company which has once announced the decision of its Board recommending a bonus issue, shall not subsequently withdraw the same.

Free reserves defined-

Note: u/s 2 (43) "free reserves" means Such reserves which, as per the latest audited balance Sheet of a company, are available for distribution as dividend.

REDUCTION OF SHARE CAPITAL

The Reduction of Share Capital means reduction of issued, subscribed and paid up share capital of the company. Previously, reduction of share capital was governed by section 100 to 104 of the Companies Act, 1956, now it is governed by **section 66** of the Companies Act, 2013. As per old act, it was subjected to the confirmation of high court, but under new Act, the said powers of high court has been transferred to National Company Law Tribunal (**NCLT**).

Buy back of shares and **redemption of Preference Shares** are also reduction of share capital but governed by specific provisions prescribed under Act. Such reductions in the form of buy back and redemption do not require sanction/approval from Tribunal (NCLT).

RIGHT ISSUE SECTION 62

A Rights issue is a easy avenue of procuring finance. It is an issue of shares in which the present shareholders have a pre-emptive right to subscribe for the new shares. In a rights issue no prospectus is issued or offer for sale of shares is made, instead existing equity shareholders are given letter of offer, an application form, in proportion to the existing holding which entitles them to take up a specified number of shares at a fixed given price the price of the shares so offered is usually below listed price to make the offer attractive.

An existing shareholder who does not wish to exercise any or all of the rights is at liberty to sell them to third parties, who can purchase such shares at a specified price. Alternatively, shareholders may renounce their rights in favour of the company which may sell the shares to the public in such a manner as the board of directors think most beneficial to the company.

SHARE CERTIFICATE

Share Certificate is that certificate which is given to the members in lieu of the shares held.

As per section 45- Every share in a company having a share capital shall be distinguished by its distinctive number

A share certificate is a prime-facie evidence of the title of the member u/s 46(1) to the shares mentioned therein.

Company is estopped from denying his title to the share, it is known as "estoppel as to title" in legal literature.

Example: Mr. Sen by fraudulent practice collects a share certificate of a company in his own name as a shareholder. After some time he sells those to Mr. Das, who buys them in good faith & applies to the company for registration of those shares in his name. The Company when discovered the fraud refuse to Mr. Das for his entitlement. At that time, company must compensate Mr. Das for the loss he has sustained by acting on the faith of the share certificate.

When the share certificate states that on each of the shares full amount has been paid, the company is estopped from alleging that they are not fully paid. This is known as estoppel as to payment"

DEMAT SYSTEM

Trading in the shares of a listed company is compulsory in dematerialized form for all investor,

The company has therefore, enlisted its shares with the depositories. The government had enacted the Depositories Act, in 1996. As per this Act two depositories were set up in India. These are

- National Securities Depository Ltd (NSDL) and the
- Central Depository Services (India) Limited (CDSL),

In India Companies are enlisted its share in NSDL and CDSL This means that people. now have the option to hold and trade in the shares of the company in electronic form.

ADVANTAGES OF DEPOSITORY SYSTEM

- Shares are held in physical or paper form in old days. Paper form of shares can be lost, theft or damaged easily. To prevent this crisis, a new system called Depository system has been established.
- Under this system, shares are held in the form of electronic accounts same as bank accounts of customer and can easily be traded.
- Trading in the shares are of a company is now under the compulsory demat segment SEBI made demat mandatory on most of the traded scrips.
- Dematerialised securities are most preferred by banks and other financiers for providing credit facilities against securities. Generally, demat securities attract lower margin and lower rates of interest compared to physical securities.

DEMATERIALISATION

Dematerialisation is a process by which the physical share certificates of an investor are taken back by the company and an equivalent number of securities are credited

in electronic form at the request of the investor. An investor will have to first open an account with a depository participant and then request for the dematerialisation of his share certificates through the depository participant so that the dematerialised holdings can be credited into the account.

This is very similar to opening a bank account.

- Dematerialisation of shares is optional and an investor can still hold shares in physical form. However, he/she has to demat the shares if he/she wishes to sell the same through the stock exchanges.
- Similarly, if an investor purchases shares, he/she will get the delivery of the shares in demat form.

TRANSFER AND TRANSMISSION OF SHARES

Transfer of shares take place when shares pass from one person to another by a voluntary act i.e by sale, gift or otherwise.

When shares passes by operation of law from one person to another, i.e. by inheritance, it is called transmission.

Transmission of shares occurs in case of death, lunacy or insolvency of a member.

PROCEDURE FOR THE TRANSFER

Section 56 of the Companies Act 2013 lay down the following procedure to be followed for the transfer of shares

- Transfer ordinarily by a member u/s 56(1),
- Transfer in the prescribed form FORM NO. SH-4 and SH-5 (Partly paid Securities).
- the legal representative of a deceased member can transfer share, although he is not himself a member u/s 56(5).

Difference between Transfer and transmission of shares

In both transfer and transmission shares pass from one person to the other.

However they differ in following respects:

- Transfer is by voluntary act of parties while transmission is by operation of law.
- Instrument of transfer i.e. transfer deed along with stamp duty is essential for transfer, but not for transmission.
- Transfer of shares not possible for private company but even a private limited company cannot refuse transmission of shares.
- In transfer the transferee does not get any liabilities which transferor may be having. In transmission shares continue with original liabilities.
- SEBI regulations regarding substantial acquisition of shares and takeover are not applicable to transmission.
- Shares are not transferable during "lock in" period but transmission is permissible, as it is by operation of law.

- Permission of official liquidator or court is necessary for transfer of share during winding up. However permission for Transmission is not required.
- Transfer must be accompanied by valid transfer form. Application for transmission is not to be accompanied by transfer form.

REDEMPTION OF PREFERENCE SHARES

Redemption of preference shares means paying back or repayment to the preference share holders.

- Section 55 of the Companies Act deals with redemption of preference shares if articles of association of the company so authorised should be redeemed.
- The preference shares must be redeemed within a period of 20 years [or 30 years in the case of infrastructure projects from the date of issue of such shares. Thus a company cannot issue irredeemable preference shares.
- No such shares shall be redeemed except out of the profits of the company which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares made for the purposes of such redemption
- No such shares shall be redeemed unless they are fully paid
- Where such shares are proposed to be redeemed out of the profits of the company there shall, out of such profits, , a sum equal to the nominal amount of the shares to be redeemed, must be transferred to the Capital Redemption Reserve Account,
- The premium, if any, payable on redemption shall be provided for out of the profits of the company, before the shares are redeemed

DEBENTURE

Definition as per Companies Act 2013 :u /s 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.

TYPES OF DEBENTURE

Classification on the basis of-

Negotiability-Registered /Unregistered

- Registered Debentures : In this class of Debentures, names of holder are recorded in the books of the company. Such debentures are not negotiable instrument.
- Bearer or Unregistered Debentures: These are debentures payable to bearer.The names of such debenture holders are not recorded in the books of the company and such debentures are transferable from hand to hand by mere delivery.

Security-Secured/ Unsecured

- Secured Debentures : This type of Debentures create some charge on the property of the company. There are two kind of charges-(a) fixed and (b) floating charge.
- Naked or Unsecured Debenture: This type of debentures does not have any charge on the assets of the company. The holder of such debentures like unsecured creditors may sue the company on debentures for the recovery of debt. These will be treated as 'deposit' and the companies (Acceptance of deposits) Rules, 2014 will be applicable.

Priority-First mortgage/ Second mortgage

- First mortgage debentures are those which are paid in priority to other debentures.
- Second mortgage debentures are those which are paid after the redemption of first mortgage debentures.

Permanence-Redeemable/ Irredeemable

- Redeemable Debentures : The Debentures are said to be redeemable when the company reserves the rights to redeem them on or after a particular date. Generally debentures are redeemable unless otherwise stated.
- Irredeemable or perpetual Debentures : When debentures are irredeemable they are called perpetual debentures. A debenture is treated as irredeemable where there is no period fixed for repayment of the principal amount it

Convertibility- Convertible/ Non convertible

- Convertible Debentures : These debentures gives an option to the holders to convertible them into preference or equity shares at stated rates of exchange after a certain period. If the holders exercise the right of conversion, they cease to be lender to the company and become members.
- Non-convertible: Such debentures are paid in cash as per the terms and are not converted into shares.

Rule 18 of the Companies (Share Capital and Debentures) Rules, 2014 relating to debentures is given below.

The Company shall not issue secured debentures unless it complies with the following conditions, namely:

- An issue of secured debentures may be made, provided the date of its redemption shall not exceed ten years from the date of issue.
- Provided that the following classes of companies may issue secured debentures for a period exceeding ten years but not exceeding thirty years.
 - Companies engaged in setting up of infrastructure projects.
 - Infrastructure Finance Companies,
 - Infrastructure Debt Fund
 - Non-Banking financial Companies ,

- Companies Permitted by Ministry or Department of Central government or by the National Housing Bank or by any other statutory authority to issue debentures.

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