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RESEARCH CORNER

- Legal, Taxation & Accounting Aspects of Reduction of Share Capital

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This article interprets and analyses the sections and sub-sections pertaining to Reduction of Share Capital as given in Companies Act, 2013 vis-a-vis the erstwhile Companies Act, 1956 with references to case laws. The examples of Types of reduction offer valuable information for Company Secretaries and other practitioners. The comprehensive understanding of the various scenarios such as Reduction in case of Loss of Capital, Overcapitalisation, amalgamation, selective reduction provides meaningful insights to the reader. Additionally, the authors address the Taxation and Accounting implications of Capital Reduction.

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INTRODUCTION

MEANING OF 'REDUCTION OF CAPITAL'

Section 66 of the Companies Act, 2013 ("the 2013 Act"), corresponding to Section 100 of the Companies Act, 1956 ("the 1956 Act") deals with Reduction of share capital of a company and lays down the requirements in regard to reduction of share capital of a company. A company limited by shares or limited by guarantee and having a share capital may, by a special resolution, reduce its share capital.

The share capital, for the purposes of this Section, means subscribed and/or paid-up share capital, and not authorised capital. Reduction of subscribed and/or paid-up capital may or may not, of course, result into consequential reduction in the authorised share capital or some other alteration of the memorandum (and also of the articles) with respect to the share capital stated therein depending upon the mode of reduction of capital.

However, regardless of reduction in the face value of a share, in most cases, its main effect is on the paid-up share capital. For instance, when a company having authorised share capital of Rs. 10 crores divided into 1 crore shares of Rs. 10 each and subscribed and paid-up capital of Rs. 5 crores divided into 50 lakhs shares of Rs. 10 each proposes to reduce 50% of its share capital, the true effect is reducing the subscribed and paid-up capital from Rs. 5 crores to Rs. 2.50 crores. In such a case, the face (nominal) of Rs. 10 may remain intact even after the proposed reduction but every shareholder will lose 50% of his subscribed and paid-up capital.

Reduction contemplated by this Section is not the same as cancellation of shares under Section 61(1) (e).

A COMPANY CAN REDUCE CAPITAL "IN ANY MANNER"

Although there are two principal methods by which share capital is reduced in reality, namely firstly, when the company has capital in excess of its needs, it extinguishes or reduces the liability of its members on any uncalled capital or it can repay to them the nominal value of their shares; and second, when the company has suffered losses, it can cancel paid-up shares because they are unrepresented by available assets, the law, however, gives companies liberty to decide the mode of reducing share capital. The reduction of share capital may be brought about in one or more of the ways namely,

(a) Extinguishment or reduction of the liability in respect of unpaid portion of the face value of any share;

(b) Cancellation of any paid-up share capital which is lost or is unrepresented by any available assets of the company;

(c) Repayments of any paid-up share capital, which is in excess of the wants of the company.

But these are only illustrations of modes of reduction of capital and not the only modes in which share capital can be reduced. Capital may be reduced in any other way. Sub-section (1) of Section 66 expressly provides that a company may reduce its share capital 'in any manner'.

Section 100(1) of the 1956 Act used the expression 'in any way' and this Section uses the words 'in any manner'. Both have the same meaning and effect. The words 'in any manner' are very wide enough to clarify that there is no limit on the modes in which capital may be reduced.

Subject to the confirmation by the court, which is required, and which is the safeguard of the minority, the question of reducing capital is a domestic one for the decision of majority, and the Companies Act leaves the company to determine the extent, the mode and the incidence of the reduction and the application of any capital moneys which the reduction may set free.[1]

It was held that the words "Subject ….. to the confirmation by the court, which is required, and which is the safeguard of the minority, the question of reducing capital is a domestic one for the decision of majority, and Companies Act leaves the company to determine the extent, the mode and the incidence of the reduction and the application of any capital moneys which the reduction may set free."[2]

The words "in any way" were held to be extremely wide and general. There were then given three particular instances of ways, but they are expressly given without prejudice to the generality of the foregoing "in any way".[3] A scheme of reduction proposed as a method for non-promoter shareholders to exit the company by paying off non-promoter equity shareholders of the company was allowed as a valid means of reduction of capital.[4]

In *Imperial Chemical Industries*, *In re*[5] Article 44 of the articles of association of a company gave the company power by special resolution to reduce the capital by paying off capital, canceling capital which had been lost or was unrepresented by available assets, reducing the liability on shares, or otherwise as might seem expedient. The Court of Appeal[6] held that on the plain meaning used in Article 44, the company took power by the article to reduce its capital in any way in which it was authorised under the statutes so to do. On appeal, the House of Lords held that the reduction so proposed was not *ultra vires* the company, as upon the true construction of Article 44 the company had power to reduce its capital in any way authorised by the Companies Act, 1929.

In *Poole* v *National Bank of China Ltd.*[7], Lord Macnaghten expressed surprise "to hear it argued …. that the Court has no jurisdiction to entertain a petition for the reduction of capital unless it be proved that the capital which the company proposes to cancel is lost or unrepresented by available assets."

> Reduction of Share Capital under Section 66 of the Companies Act, 2013, is a significant restructuring tool that enables companies to cancel unutilized capital, return excess capital, or extinguish liability on unpaid capital. However, it can have multiple tax implications, especially in the hands of shareholders.

The phrase "in any way", meaning in any manner, without any particular way or method, is a clear indication of the legislative intent, namely that a company is free to resort to any manner or mode or method of reducing its share capital and that there is no restriction on how or in what way a company may do it. The Section does not place any fetter on the power of the company. With regard to the expression "*without prejudice to the generality of the foregoing power*", the Supreme Court has held that, anything contained following this expression is not intended to cut down the generality of the meaning of the preceding provision.[8] When general provisions are followed by certain particular provision and when it is stated that the particular provisions are without prejudice to the general provision the particular provisions do not cut down the generality of the meaning of the preceding general provisions.[9]

It is well-settled that the enumeration of the specific matters 'without prejudice to the generality' of a particular provision does not restrict the general application of that provision to the matters enumerated because the words 'without prejudice' have the effect of preserving the full effect of the general provision and also because the rule of *ejusdem generis* has no inverse application.[10]

In *Pasupati Acrylon Ltd, In re*[11], the company was unable to pay its debts having incurred huge losses. Company approached the joint lenders to restructure its debts under Debt Restructuring Mechanism which was approved with the condition to reduce 10% share capital of the company. Shareholders approved the same and High Court confirmed the scheme of reduction of capital.

In *Comtec Components Ltd., In re*[12], confirming the proposal the court held that the decision taken for reduction of share capital is purely a commercial decision to have a true reflection of the financial position of the company; considering the fact that such move has been approved by the overwhelming majority of the shareholders, apart from the fact that such reduction does not involve any cash out flow to prejudice the rights of the creditors, the proposal was to be confirmed.

Several cases have been reported in the recent past on the question whether the High Court has the power to sanction reduction of capital under Section 100 of the Companies Act, 1956, if the reduction is of only some and not all of the members of the company, and it has held in all such cases that the High Court can sanction such reduction of capital.

Once again, in *RS Livemedia P. Ltd., In re*[13], the Delhi High Court has sanctioned such selective reduction and

1. *See Buckley on the Companies Act, 2000 edition, paragraph 135.24.*
2. *Buckley on the Companies Act, 2000 edition, para 135.24.*
3. *Re, Ratners Group plc. (1988) 4 BCC 293: (1988) BCLC 685 (Ch D).*
4. *Organon (India) Ltd., In re (2010) 157 Comp Cas 287 (Bom).*
5. *(1937) AC 707: (1938) 8 Comp Cas 181 (HL).*
6. *Carruth v Imperial Chemical Industries (1938) 8 Comp Cas 86 (CA).*
7. *(1907) AC 229.*
8. *Shiv Kripal Singh v VV Giri AIR 1970 SC 2097: (1970) 2 SCC 567.*
9. *Raja Gowl Rajasimha Rao v State of A P AIR 1973 AP 236.*
10. *Seshkumar Pradhan v Keshav Narayan Acharya 1980 MPLJ 335.*
11. *(2007) 140 Comp Cas 702 (All).*
12. *(2014) 186 Comp Cas 311 (Mad).*
13. *(2014) 187 Comp Cas 243 (Del).*

held that Section 100 of the Companies Act, 1956, enables a company to reduce its capital provided it is authorised by its articles of association and members of the company approve by a special resolution. Clauses (*a*) to (*c*) of Section 100(1) are merely illustrative and not exhaustive. The words "without prejudice to the generality of the foregoing power" expressly indicate that the power of a company to reduce its capital is not circumscribed by clauses (*a*) to (*c*) of Section 100(1) of the Act.

It is permissible for a company to reduce its share capital in a disproportionate manner and consideration payable to different shareholders on account of reduction of share capital can be calculated at different rates. The mode, manner and incidence of reduction has been regarded as a matter of domestic concern and there is no restriction under the Act which curtails the discretion of a company in adopting the manner in which the company chooses to reduce its capital.

Examples of types of reduction[14]

Examples of types of reduction of capital, extracted from decided cases.—

(a) Reducing the liability of shareholders in respect of uncalled or unpaid capital, *e.g.,* where the shares are ₹10 each with ₹5 paid up, reducing them to ₹5 fully paid-up shares, and thus relieving the shareholders from liability of the uncalled amount.

(b) Paying off or returning paid-up capital not wanted for the purposes of the company, *e.g.,* where the shares are ₹10 fully paid up, reducing them to ₹5, and paying back ₹5 per share. Section 100 expressly provides that this kind of reduction is to be allowable.

(c) Paying off unpaid-up capital by issuing debentures or debenture stock in satisfaction or where a company is satisfied that it can finance its requirements to the extent of capital repaid by raising money or loan or borrowing from its bankers.

(d) Paying off paid-up capital on the footing that it may be called up again. Thus, if the shares are ₹10 fully paid up, paying off 5 per share' on the footing that when desired the company may call it up again. Repaying capital to the holders of fully paid up shares of a class on the footing that it can be called up again so as to bring them into line with the partly paid shares of the class.

(e) Cancelling shares surrendered, or the holders of which consent to cancellation.

(f) Paying off and cancelling preference shares, in pursuance of a contract in the memorandum and articles binding on both preference and ordinary shareholders, by applying for the purpose, a portion of the profits of the company.

(g) Lost capital. Cancelling capital which has been lost or is unrepresented by available assets. This is one of the commonest modes of reduction. A company, whose capital amounts to ₹1,00,000, has lost, say ₹50,000 by continued adversity or by some business disaster. The company can write off the lost capital.

(h) A company may reduce its share capital by cancelling part of the paid-up capital and then restructure its capital by sub-dividing or consolidating the remaining shares. However, if such restructuring is accompanied by a selective reallocation or allotment to only a subset of shareholders, such action must be implemented under a Court-approved Scheme of Arrangement (Sections 230–232), of Companies Act, 2013), ensuring compliance with minority protection principles.
(i) Cancelling shares of two members by agreement to repay the company, the losses resulting from misappropriation of funds by an official.

(j) Reduction to rectify an irregular repayment or purchase of shares by the directors.

(k) Reduction in excess of the wants of the company satisfied by the distribution of investments of greater value than the amount of the reduction.

(l) Reduction to reduce all shares of a company which has lost its register of members and cancel all shares the holders of which do not signify their wish to continue as members.

(m) Reduction in excess of the wants of the company by a return to the shareholders of excess capital at par or at premium (the premium will be drawn from the reserves and/or accumulated profits).

(n) Paying off part of the shares out of capital in excess of wants so as to enable the holders of the remaining shares in effect to acquire the interest of those paid off and become the only shareholders.

(o) Where the amount unpaid on shares was cancelled and money was raised by the *issue* of new shares.

(p) The cancellation of all the share capital as part of a scheme of arrangement.

REDUCTION IN CASE OF LOSS OF CAPITAL

Clause (b)(i) of Section 66(1) (similar to clause (b) of sub-section (1) of Section 100 of the 1956 Act), recognises as a mode of reduction of share capital, cancellation by a company, either with or without extinguishing or reducing liability on any of its shares, or any paid-up share capital which is lost, or is unrepresented by available assets.

Reducing the paid-up share capital by writing off a certain portion of the paid-up value of each share which is fully paid-up, and then consolidating the shares of such reduced value into the share of the desired value is one of the common modes of reduction of capital. The aggregate of the written-off portion of each share is applied for writing off loss or other fictitious assets. Thus, in this mode of reduction of capital, the paid-up share capital is reduced by cancellation of certain portion of the paid-up value of the shares, which is lost or unrepresented by the available assets of the company.

14. *Adapted from Palmer's Company Precedents, 17th edition, Vol. I, pages 998-1000.*

In *Palmer's Company Law*, 25th edition, para 4.305, it is stated as follows:

> "This is one of the most common modes of reduction, and is a very useful means of reintroducing reality into the balance sheet position of the company. Where a company has lost a large part of its capital so that its profit and loss account is heavily in debit, the effect is, *inter alia*, that the assets side of the balance sheet will show an item (the profit and loss account debit balance) which will prevent the distribution of dividends until the loss has been eradicated by subsequent profits. As far back as 1877, it was realised that it is desirable for the company to be able to write off the loss and put itself with a clear balance sheet in a position to resume payment of dividends out of subsequent profits."
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> The factors which the court considers were described by Buckley J in *Re, Welsbach Incandescent Gas Light Co Ltd*[15] as follows:
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> "...... it is to be borne in mind that when a company is writing off lost capital it is in a sense doing something which is no injury, but on the contrary is a benefit to its shareholders. The effect of the writing off of the loss may be — and its object generally is — to enable the company to resume payment of dividends, which, of course is for the benefit of the shareholders. It results, no doubt, in the reduction of the nominal amount of the shares; and, inasmuch as the nominal amount of a share has some commercial effect on the saleable value, it may affect the shareholder in that way. Broadly speaking, however, a reduction of capital by writing off loss is, I repeat, not to the injury, but to the benefit of the shareholder. The persons whom it may injure are the creditors (if any). The result of writing off the loss is, that the company is no longer bound to keep to the balance of its debit in respect of capital as large a sum; but, to the extent to which it resumes paying dividends at an earlier date, of course the creditors lose assets to which they would otherwise be entitled. The question whether the loss has been sustained, therefore, is always one which is carefully looked into by the court for the purpose of protecting the creditors."

Cancelling capital which has been lost or is unrepresented by available assets is one of the commonest modes of reduction. Where a company has lost part of its capital, nothing can be more beneficial to the company than to admit the loss, and to write it off, e.g., to reduce part of its capital and thus place itself in a position to resume payment of dividends, or raise further capital.[16] The provisions empowering a company to cancel any paid-up share capital which is lost or unrepresented by available assets are alternative provisions, and the latter is not explanatory of the former.[17]

It may be noted that clause (b) of sub-section (1) of Section 66 itself permits cancellation of any paid-up share capital with two alternative motives, namely—(a) cancellation of any paid-up share capital because of loss of capital; and (b) cancellation of any paid-up share capital because it is unrepresented by available assets. That these two modes are alternative to each other is clear from the use of the disjunctive "or".

In one case, a company sought court approval of a reduction in its capital and share premium account on the grounds that the capital had been lost or was unrepresented by available assets. The reduction was sought in order to reflect the loss the company had incurred as a result of unexpected defects in property it owned. However, in the affidavit supporting the petition it was stated that the company had been advised by counsel that it had more than an even chance of succeeding in recovering damages for the loss attributable to the defective property. The court held that, where a company seeks to reduce its capital on the grounds that it has been lost, the loss of capital must be a permanent loss so far as was presently foreseeable and not a temporary fall in the value of some capital asset. On the facts, it was not proved that there had been a permanent loss of capital and the court could not confirm the reduction on that ground. However, since the company had given an undertaking to place in capital reserve any sums recovered with respect to the defective property up to the amount of the reduction sought and thus there would be no possibility of moneys which represented capital of the company being used to pay a dividend, the court would exercise its discretion under Section 68 of the Companies Act, 1948 to confirm the reduction on this basis.[18]

REDUCTION IN CASE OF OVERCAPITALIZATION

According to clause (b) of sub-section (1), of Section 66 a company may reduce its share capital either with or without extinguishing or reducing liability on any of its shares, pay off any paid-up share capital which is in excess of the wants of the company. This clause enables a company to reduce its share capital by paying off to its shareholders a part of the share capital of the company.

In the *Palmer's Company Law,* 25th edition, para 4.304, it is stated:

"A company may wish to repay capital either because it is in excess of its needs or because it may wish to obtain fresh capital more cheaply elsewhere.[19] It may do this by:—

(a) extinguishing or reducing the liability of shareholders in respect of uncalled or unpaid capital;

(b) paying off or returning paid-up capital not wanted for the purposes of the company;

(c) paying off paid-up capital on the footing that it may be called up again. Thus, if the shares are £10 fully paid up, paying off £2 per share on the footing that when desired the company may call it up again, the uncalled liability not being extinguished;

(d) a combination of the preceding methods.

15. *(1904) 1 Ch 87, 89 LT 645 at 647, 648 (CA).*
16. *In Ebbw Vale Steel, etc.. Co. (1877) 4 Ch.D. 827.*
17. *Re, Hoare & Co. Ltd. (1904) 2 Ch. 208.*
18. *Re, Jupiter House Investments (Cambridge) Ltd (1985) BCLC 222: (1985) BCC 99, 456 (Ch D).*
19. *On a fluctuation of interest rates or fiscal considerations: e.g. Lawrie & Symington Ltd., Petitioners 1969 SLT 221; David Bell Ltd. 1954 SC 33.*

A company need not necessarily return cash to the shareholders. It may return capital in kind and such assets may be in excess of the amount by which the paid-up value of the shares is reduced, provided that the company does not thereby render itself insolvent.[20] If a company acquires its own shares on a reduction of capital this is permitted method of such acquisition."

This mode of reduction of capital is often resorted to where a company is overcapitalized and wishes to restructure its share capital by repayment of the capital which is in excess of its wants. The excess capital is returned to the shareholders in cash or by exchange of different shares.

A company may find itself overcapitalized, that is to say, its capital is in excess of its needs or wants, so it can repay a part of its subscribed and paid-up share capital, or it may realize that restructuring its capital by repaying a part of the capital and replacing it by some cheaper finance, in the form either share capital or some other form (*e.g.* loan capital) would be more conducive to its business and profitability. In such eventualities, a company may resort to reduction of capital by repaying it (at par or at a premium). A company may repay share capital at a premium, *i.e.* at a sum higher than the face value of the shares. For example, a company may repay Rs. 5 per shares of the face value of Rs. 10 at Rs. 25, so that it will be said to be repaying capital of Rs. 5 at a premium of Rs. 20 per share. If the company wishes to repay capital at a value higher than the face value of the shares comprised in the reduction (which would be the situation in most cases of profitable companies with accumulated profits), two requirements become imperative: first, the company must have adequate liquid funds to meet the repayment obligation on account of both, the face value as well as the premium. Secondly, the company must have adequate accumulated profits in the form of reserves or profit and loss account credit balance. In such a case, the amount of the premium would be drawn from the existing share premium if any and / or from the accumulated profits or reserves or both, as the case may be.

REDUCTION OF CAPITAL IN A SCHEME OF AMALGAMATION

There was no legal impediment for reduction of share capital being a part of the scheme of amalgamation. It is permissible under rule 85 of the Companies (Court) Rules, 1959. All that is required is that the procedure prescribed for reduction of share capital be complied with. Where there was a substantial compliance of the procedure under Section 100 of 1956 Act and now with Section 66 of 2013 Act, reduction of share capital can be brought about as a part of the scheme of compromise, arrangement or amalgamation.[21]

SELECTIVE REDUCTION OF CAPITAL

When a company proposes to reduce share capital by repayment to only some of, and not all, of its shareholders, it is called 'selective reduction of capital. Selective reduction was held to be permissible within the framework of law for any company limited by shares. Extinguishment of portion of equity shares permissible.[22] Selective reduction of share capital is legally permissible.[23]

It is permissible for a company to reduce its share capital in a disproportionate manner and consideration payable to different shareholders on account of reduction of share capital can be calculated at different rates. The mode, manner and incidence of reduction have been regarded as a matter of domestic concern and there is no restriction under the Act which curtails the discretion of a company in adopting the manner in which the company chooses to reduce its capital.

There are a number of precedents with regard to the petitions for 'selective reduction of capital' under Section 100 of the 1956 Act and they are binding on the NCLT and will be followed in considering petitions filed under Section 66 of the 2013 Act, which corresponds to and is substantially similar to the provisions of Section 100 of the 1956 Act. Various Courts in India have laid down the lawfulness and validity of the principle of *selective buyback of shares by way of reduction of capital,* starting with the Division Bench decision in the case of *Sandvik Asia Ltd v Bharat Kumar Padamsi*.[24] Thereafter, in a series of decisions of the Bombay and some other High Courts.

The Bombay High Court has held that the adoption by Parliament of the words "any shareholders" in Section 101 of the Companies Act, 1956 indicates that a reduction of share capital need not necessarily be qua all shareholders of the company, but can take place from one or more amongst the body of shareholders. A classification of shareholders for the purposes of effecting the reduction of capital is, therefore, not an act which is extraneous to the provisions of Section 101. The Court must give effect to the plain meaning and intendment of the provisions of Section 101. Corporate autonomy must have a wholesome recognition in law and unless the law circumscribes it by a clear provision, the Court would not read limitations where the Legislature has not imposed them.[25]

British and American Trustee and Finance Corporation v Couper[26] is a clear-cut authority on this proposition. There, a company carried on business in the United Kingdom and in America, and a portion of its investments and some of its shareholders were in America. Differences having arisen between the directors in England and the American committee, it was agreed that the American shareholders should take over the American investments upon the terms that the company should cease to carry on

20. *Exp. Westbum Sugar Refineries Ltd. (1951) AC 625. In a South African case it was held that the grant to shareholders of a permanent right to occupy flats belonging to the company was not a return of capital in kind: Rosslare (Pty) Ltd. v Registrar of Companies (1972) S.A.loR. (2) 524 (SA).*
21. *Comat Infoscribe Pvt Ltd., In re (2005) 128 Comp Cas 152 (Kar).*

22. *Re, Siel Ltd, (2008) 144 Comp Cas 469 (Del).*
23. *Re, Elpro International Ltd, (2009) 149 Comp Cas 646 (Bom).*
24. *Sandvik Asia Ltd v Bharat Kumar Padamsi, [2009] 151 Comp Cas 251 (Bom).*
25. *Re, Elpro International Ltd, [2009] 149 Comp Cas 646 (Bom).*
26. *British and American Trustee and Finance Corporation v Couper, 1894 AC 399 : (1891-4) All ER Rep. 667 (HL).*

business in America and the capital of the company should be reduced by the amount of the shares held in America. A special resolution for carrying out this agreement was passed and confirmed. All the creditors of the company had either been paid or had assented to the arrangement. The House of Lords held that the arrangement was not *ultra vires* the company, and should be sanctioned by the court.

In *British and American Trustee and Finance Corporation v Couper*[27], it was observed: "If there is nothing unfair *or* inequitable in the transaction, I cannot see that there is any objection to allowing a company limited by shares to extinguish some of its shares without dealing in the same manner with all other shares of the same class. There may be no inequality in the treatment of a class of shareholders, although they are not all paid in the same coin, *or* in coin of the same denomination."

In *Re, Robert Stephen Holdings Ltd,*[28] the proposed reduction was to be effected, by return of capital paid on a certain number of shares held outside one Rubin family and cancellation of such shares. The Rubin shareholders had all consented to the reduction but the consent of all ordinary shareholders had not been obtained. Confirming the reduction, in *Buckley on the Companies Act,* it is stated:

A reduction … by which capital moneys are to be returned to some or only and not to all shareholders may be resolved upon and confirmed if it be fair and equitable. However, where the reduction involves paying a part of the share capital and not all the shareholders have consented, it is desirable to proceed by way of a scheme of arrangement under Companies Act, 1985,[29] Section 425, which provides better protection for the interests of the minority shareholders than is provided by the right of a dissentient to oppose the petition for the reduction.[30]

In *Carruth v Imperial Chemical Industries* (supra), Lord Maugham observed:

….. I think the fairness or unfairness of the scheme as a whole, including the reduction, is not a matter for the discretion of the learned Judge in a technical sense, but is a matter to be decided on the evidence. The question in this case depends on the view which should be taken as to the future commercial success of the company. We are not entitled to substitute our own views for those of the directors and experts who have given evidence. Considerably importance should be attached to the unanimous opinion of the directors whose good faith I repeat is not in question, and having regard to their standing and position I think little weight can be given to the circumstance that their combined holding are predominantly in ordinary shares. I am also impressed by the fairness and candour with which the experts called on behalf of the company gave the evidence.[31]

In *Re, Sandvik Asia Ltd,*[32] a proposal for reduction of the share capital of the appellant-company approved by a majority of 99.95% of its equity shareholders present in the meeting convened for that purpose was objected to by the respondents who were non-promoter shareholders. It was contended that a scheme for reduction could not be resorted to in order to extinguish an entire class of public shareholders. The single judge declined sanction on the ground that amongst the paid-up equity shareholders, there were distinct groups, the promoters group and the non-promoters group and therefore, a meeting of non-promoters group ought to have been convened separately and that the minority shareholders were not given any option under the proposal. Thus, the proposal was for reduction of capital by paying it off at a premium to the shareholders other than the company's promoters. They were given no option for not opting for the repayment of capital. S Radhakrishna J. of the Bombay High Court held that even a single minority shareholder was entitled to oppose the proposal and if the court found the scheme to be unjust, the court should not confirm the reduction as proposed. Dismissing the petition, a single Judge held that the proposal was highly inequitable, unjust and unfair, in the sense that the minority shareholders will have to leave the company. Therefore, the promoters group could virtually bulldoze the minority shareholders and purchase their shares at the price dictated by them. However, allowing the appeal and setting aside the decision of the single Judge, the Division Bench held that the non-promoter shareholders were being paid a fair value for their shares and an overwhelming majority of the non-promoter shareholders had voted in favour of the resolution. There was no justification in withholding sanction of the resolution. The prayer for reduction was to be allowed.[33] The Division Bench held that there was no justification in withholding sanction of the resolution. The prayer for reduction was allowed. [see *Sandvik Asia Ltd v Bharat Kumar Padamsi*].[34]

The Bombay High Court has taken similar view in *re, Elpro International Ltd*.[35]

The ratio that can be derived from all the above cited cases is that, the Act leaves the company to decide for itself the extent and mode of reduction of the capital and that the courts will consider the reduction of capital as a domestic affair to be decided by the majority. However, concurrently, the responsibility of the court would be to safeguard the interests of the minority shareholders and creditors and seeing that the reduction is fair and reasonable. One more general principle that can be deduced from the decided cases is that, the courts do consider the equitability (being fair and reasonable; treating everyone in an equal way) as one of the cardinal requirements for sanctioning a scheme of reduction of capital; and if the scheme is inequitable to some, consent of those who are likely to be so affected, would be necessary for sanctioning of the scheme.

27. *British and American Trustee and Finance Corporation v Couper, 1894 AC 399 : (1891-4) All ER Rep. 667 (HL).*
28. *Re, Robert Stephen Holdings Ltd, (1968) 1 All ER 197.*
29. *The English Companies Act, 1985.*
30. *Buckley on the Companies Act, 2000 Edn, Vol I, para 135.25.*
31. *Re, Carruth Imperial Chemical Industries, (1937) AC 707 : (1938) 8 Comp Cas 181, per Lord Maugham.*
32. *Re, Sandvik Asia Ltd, (2004) 121 Comp Cas 58 (Bom): (2004) 58 CLA 125 (Bom).*
33. *Sandvik Asia Ltd v Bharat Kumar Padamsi, [2009] 151 Comp Cas 251 (Bom).*
34. *Sandvik Asia Ltd v Bharat Kumar Padamsi, [2009] 151 Comp Cas 251 (Bom).*
35. *Re, Elpro International Ltd, [2009] 149 Comp Cas 646 (Bom).*

There is nothing in the Section regarding value of the shares and the extent of reduction and therefore a company may go to any extent in writing off the paid-up value of a share, even writing off the entire share capital of the company. In *re, Wartsila India Ltd,*[36] the Bombay High Court has held that the role of the court whilst approving schemes is limited to the extent of ensuring that the scheme is not unconscionable or illegal or unfair or unjust. Merely because the determination of the valuation of shares is done by a different method which might result in a different conclusion, it alone would not justify interference, unless found to be unfair.

In *Re, Comtec Components Ltd,*[37] confirming the proposal the court held that the decision taken for reduction of share capital is purely a commercial decision to have a true reflection of the financial position of the company; considering the fact that such move has been approved by the overwhelming majority of the shareholders, apart from the fact that such reduction does not involve any cash outflow to prejudice the rights of the creditors, the proposal was to be confirmed.

In *Chander Bhan Gandhi v Reckitt Benckiser (India) Ltd,*[38] the single judge allowed the reduction holding, *inter alia*, that separate meeting of classes of shareholders was not necessary and also that the valuation of shares could not be faulted. On appeal, affirming the decision of the single judge of the Delhi High Court in *Re, Reckitt Benckiser (India) Ltd,*[39] it was held, dismissing the appeal, that there was no fault in the reasoning given by the single judge while approving the action of the company reducing the share capital. There could be no better index of valuation than market forces. The company had increased the valuation from Rs. 836 to 940 and further to Rs. 1,500 per share, which was accepted by all the other public shareholders. It established that Rs. 1,500 was the correct price.

Once again, in *Re, RS Livemedia Pvt Ltd,*[40] the Delhi High Court has sanctioned such selective reduction and held that Section 100 of the Companies Act, 1956, enables a company to reduce its capital provided it is authorised by its articles of association and members of the company approve it by a special resolution. Clauses (a) to (c) of Section 100(1) are merely illustrative and not exhaustive.

SELECTIVE REDUCTION OF CAPITAL AS PART OF A SCHEME OF CONTRACT OR ARRANGEMENT

The above question was before the T & AP High Court in *Astirix Laboratories Ltd,*[41] but with regard to a scheme of compromise or arrangement. In this case, the scheme provided, among other things, for the cancellation and extinguishment of the equity shares held by its minority shareholders by paying cash in lieu of equity shares held by them. The five minority shareholders objected to the valuation of their shares contending (i) that the valuer to which the valuation of shares was assigned was not an independent one as it was the advisor of one of the major shareholders of the transferee company, and (ii) that the valuer had not made a fair valuation of the shares. The High Court held that such a reduction was permissible and there were no serious anomalies in the valuation report.

TAXATION AND ACCOUNTING ASPECTS OF CAPITAL REDUCTION

Taxation aspects:

The question whether reduction of capital constitutes 'transfer' under Section 2(47) of the Income Tax Act has been answered by the Supreme Court in *Principal Commissioner of Income Tax-4 v. Jupiter Capital Pvt. Ltd.*[42] The assessee had claimed capital loss arising due to reduction in share capital by the company (which was the assessee's subsidiary company) in which the assessee had shareholding, and subsequent proportionate reduction in shareholding of assessee. The Supreme Court held that the said capital loss would be covered within ambit of expression "sale, exchange or relinquishment of asset" used in Section 2(47) the Income Tax Act, 1961. Since the assessee was holding 15,33,40,900 shares prior to reduction and 9988 shares after reduction, it could be said that on account of reduction in number of shares held by assessee in company, assessee had extinguished its right of 15,33,40,900 shares, and in lieu thereof, had received 9988 shares at Rs. 10 each along with an amount of Rs. 3,17,83,474 - Assessee's claim for capital loss on account of reduction in share capital was rightly allowed.

The Supreme Court relied on its earlier decision in *Kartikeya v Sarabhai v. Commissioner of Income Tax*[43] in which it was held that on a reduction of share capital with the company paying a part of the capital by reducing face value of its share, results in extinguishment of right in the shares held by the share-holder and the amount paid on reduction of share capital would be exigible to capital gain tax. It is not necessary that for a capital gain to arise that there must be a sale of a capital asset. Sale is only one of the modes of transfer envisaged by Section 2(47) of the Act. Relinquishment of the asset or the extinguishment of any right in it, which may not amount to sale, can also be considered as a transfer and any profit or gain which arises from the transfer of a capital asset is liable to be taxed under Section 45 of the Act."[44]

Capital reduction is a strategic corporate action governed by Section 66 of the Companies Act, 2013, wherein a company reduces its issued, subscribed, or paid-up share capital in a legally compliant manner. This process may involve extinguishing or reducing liabilities on unpaid share capital, cancelling paid-up capital that is lost or

36. *Re, Wartsila India Ltd, [2010] 160 Comp Cas 508.*
37. *Re, Comtec Components Ltd, [2014] 186 Comp Cas 311 (Mad).*
38. *Chander Bhan Gandhi v Reckitt Benckiser (India) Ltd, [2012] 170 Comp Cas 363 (Delhi).*
39. *Re, Reckitt Benckiser (India) Ltd, [2011] 167 Comp Cas 541.*
40. *Re, RS Livemedia Pvt Ltd, [2014] 187 Comp Cas 243 (Delhi).*
41. *Astirix Laboratories Ltd, [2015] 191 Comp Cas 376 (T & AP).*
42. *AIROnline 2025 SC 167*
43. *(1997) 7 SCC 524:AIR 1997 SC 3794*
44. *In this judgment the term 'reduction of face value' should be read as 'reduction of paid-up value'*

unrepresented by assets, or paying off excess capital to shareholders. While it serves various corporate objectives such as restructuring, capital optimization, and returning surplus funds to shareholders, it also triggers significant implications under the Income Tax Act, 1961, and necessitates accurate financial reporting under Ind AS and Indian GAAP.

Reduction of share capital under Section 66 of the Companies Act, 2013, is a significant restructuring tool that enables companies to cancel unutilized capital, return excess capital, or extinguish liability on unpaid capital. However, it can have multiple tax implications, especially in the hands of shareholders.

As per the Income Tax Act, 1961, capital reduction often results in a 'transfer' as defined in Section 2(47), which leads to computation of capital gains or losses under Section 45. The treatment varies based on the manner in which the reduction is effected i.e. cash payout, extinguishment, issue of debentures, or in-kind distributions. While the legal route is well-established, the tax implications—particularly for shareholders—can be complex and must be carefully considered to ensure compliance and tax efficiency.

1. **Taxation Implications of Reduction of Share Capital under the Income Tax Act, 1961**

   Capital Reduction as a 'Transfer' under the Income Tax Act

   The Income Tax Act, 1961 defines "transfer" under Section 2(47) in a wide manner. It includes sale, exchange, relinquishment, extinguishment of any right, and compulsory acquisition. When a company reduces its share capital, and in the process either pays shareholders or cancels shares, there is an extinguishment of rights in shares—triggering capital gains tax.

   The Supreme Court in ***Kartikeya V. Sarabhai v. CIT***[45] held that even where only a part of the share capital is extinguished, it results in a taxable transfer. This position was reaffirmed by the Supreme Court in ***Jupiter Capital Pvt. Ltd.***[46], where the Court allowed the claim of capital loss arising from such extinguishment.

2. **Modes of Capital Reduction and Corresponding Tax Treatments**

   a) **Cash payout to shareholders**

   When a company reduces its share capital by returning cash (in whole or part) to shareholders, it results in extinguishment of shareholder rights, which qualifies as a 'transfer' under Section 2(47), Supreme Court in *Jupiter Capital Pvt Ltd (2025).* The amount received over and above the cost of acquisition (COA) is taxed as capital gain under Section 45. Cost of Acquisition, adjusted to face value or original purchase price proportionately, as per Section 48. Benefit of Indexation is available in this case as per normal LTCG/STCG provisions.

   b) **Cancellation of shares without consideration**

   Even without monetary payout, the extinguishment of rights is considered a transfer. Where shares are cancelled without any payout (such as extinguishing partly paid shares or surrendered shares), taxability depends on whether any cost of acquisition exists.

   If COA > 0: Capital loss may be claimed. If COA = 0 (e.g., bonus shares): No gain/loss.

   c) **In-kind distribution**

   When the reduction is effected by transferring a non-cash asset (like land, securities, or other investments) instead of cash, during capital reduction, the fair market value (FMV) of the asset is deemed as the consideration for computing capital gains. The principle laid down in ***CIT v. George Henderson & Co Ltd***[47] applies.

   d) **Selective reduction**

   In selective capital reduction—where only a class of shareholders (e.g., public or non-promoters) is paid off—the affected shareholders are considered to have relinquished their rights in exchange for consideration. It results in capital gains tax computation for the affected shareholders. ***Sandvik Asia Ltd. v. Bharat Kumar Padamsi***[48] confirms the validity of such reduction schemes. Capital Gains in such case is taxable for the affected shareholders under Section 45. Fair Market Value may be considered under Section 50CA, if shares are unlisted and consideration is lower than FMV.

   e) **Reduction as part of amalgamation**

   If capital reduction is part of a court-approved amalgamation scheme (now NCLT), and shareholders receive shares in the transferee company, such transaction may be tax-neutral under Section 47(vii) subject to fulfilment of Conditions, 1) Amalgamation should satisfy Sec. 2(1B) and 2) Consideration must be in equity shares only in exchange for original shares [***CIT v. Gautam Sarabhai Trust***[49].

45. *[(1997) 228 ITR 163 (SC)]*
46. *[AIR Online 2025 SC 167]*
47. *[(1967) 66 ITR 622 (SC)]*
48. *(2009) 150 CompCas 545 (Bom)*

f) **Payout at premium**

When shares are paid off at a value higher than face value (e.g., Rs 10 share repaid at Rs 25), the entire amount less COA is considered as taxable capital gains. However, in such cases, premium must be backed by free reserves or securities premium as per the provisions of the Companies Act, 2013.

g) **Reduction with return of capital without full extinguishment**

If part of capital is returned but the shareholding continues, extinguishment test may not apply fully. However, as held in ***Anarkali Sarabhai v. CIT***[50], even partial extinguishment is taxable. As a result, the amount received less proportionate cost is taxable capital gain.

h) **Preference shares buyback / reduction**

If issued at par and redeemed/reduced at premium, will be taxable in shareholder hands depending on the extinguishment value. Difference received by the preference shareholder, over the cost is taxable as capital gain.

i) **Applicability of Section 2(22)(d) – deemed dividend**

Any distribution by a company to its shareholders on reduction of share capital, to the extent it represents accumulated profits (whether capitalised or not), is treated as deemed dividend under Section 2(22)(d) of the Income-tax Act, 1961. However, the Supreme Court in Anarkali Sarabhai v. CIT[51] clarified that where the distribution on capital reduction does not fall within the scope of Section 2(22), it shall be treated as transfer of a capital asset, and capital gains provisions under Section 45 would apply.

j) **Buyback provisions not applicable**

Even though buyback of shares as per Section 68 of the Companies Act 2013 also results in reduction of capital. However, it is not the same as reduction of capital as per Section 66. The prime difference being the mode of implementation. While reduction of capital under Section 68 happens with the authority of the Board or the Shareholders depending on the quantum of buyback, reduction of capital as per Section 66 is essentially done with the approval of the NCLT. Section 115QA applies only for "buy-back" under Section 68 of Companies Act, not to reduction of capital under Section 66.

k) **Capital loss treatment**

If reduction leads to a loss (i.e., consideration < COA), such capital loss is eligible for set-off or carry forward under Section 70 (intra-head) and Section 74 (inter-year). Accordingly, capital losses arising from reduction are eligible for set-off and carry forward under Sections 70 and 74, respectively, as held in ***Jupiter Capital Pvt. Ltd***.[52]

l) **For Non-residents**

In case of non-residents shareholders, capital gains from Indian company shares are taxable in India under Section 9(1)(i), subject to DTAA relief. Treaty benefits (like India–Singapore or India–Mauritius) may override domestic provisions if applicable.

II. Accounting aspects

Reduction of share capital impacts the presentation and measurement of equity, related reserves and the assets. Reduction of share capital, though legal in nature, has deep implications for financial reporting. Under both Indian Accounting Standards (Ind AS) and Indian GAAP, such events affect the company's equity, reserve balances, assets and potentially its ability to declare dividends. Capital reduction impacts the shareholders' equity section of the balance sheet and may require restatement of reserves, capital accounts, or accumulated losses. The accounting treatment depends on the form of reduction i.e. extinguishment of liability, cancellation of capital, or payout.

Accounting treatment for capital reduction in some cases will also depend on whether the entity is covered under Ind AS or Indian GAAP (I-GAAP). Different standards under Ind AS and I-GAAP govern the accounting entries, disclosure, and classification of such transactions. The treatment depends on the nature of the reduction and is governed by different accounting standards under Ind AS and I-GAAP. The ones applicable in such situations are listed here below.

1. Indian Accounting Standards (Ind AS) relevant to capital reduction:

Under Ind AS, capital reduction accounting is governed by the following standards:

(a) Ind AS 1 Presentation of Financial Statements, is the most frequently applied standard, dealing with equity, restructuring, and capital disclosures.

(b) Ind AS 10 Events After Reporting Period, is applicable when reduction is approved after the reporting date but before signing of financials.

49. *(1988) 173 ITR 216 (Guj)*

50. *[(1997) 224 ITR 422 (SC)]*

51. *[(1997) 224 ITR 422 (SC)]*

52. *(SC, 2025)*

(c) Ind AS 32 Financial Instruments: Presentation, governs classification of equity vs liabilities, relevant in capital restructuring.

(d) Ind AS 103 Business Combinations, applies when reduction is part of amalgamation/restructuring schemes.

(e) Ind AS 109: Financial Instruments, covers various aspects of different forms of financial instruments their presentation and related disclosures.

(f) Division II– of Schedule III of Companies Act, 2013 stipulates norms of presentation of financial statements and disclosures therefor.

2. Accounting Standards or I-GAAP relevant to capital reduction:

Under Indian GAAP (I-GAAP), capital reduction accounting is governed by the following standards:

1. **AS 1:** Disclosure of Accounting Policies
2. **AS 4:** Contingencies and Events Occurring After the Balance Sheet Date
3. **AS 10:** Property Plant & Equipment (for in-kind adjustments)
4. **AS 14:** Accounting for Amalgamations (in schemes involving capital restructuring)
5. **Division I** – of Schedule III of Companies Act, 2013 stipulates norms of presentation of financial statements and for disclosures thereof.

3. Forms of capital reduction and corresponding Accounting Treatments

As listed hereinabove, there are different accounting standards under Ind AS and I-GAAP, that would be applicable to different situations of capital reduction as regards the measurement, presentation and disclosures. However, the nature of accounting entries would still be the same majorly, irrespective of whether the entity is required to follow Ind AS or I-GAAP. Discussions in the following paragraphs, explains accounting treat with regard to the specific situations of capital reduction.

a) Extinguishment of unpaid share capital

This involves waiving the unpaid liability on partly paid shares. When a company extinguishes liability on partly paid shares to the extent of the unpaid portion, no accounting entry is required. It would only require disclosure in the notes to accounts in accordance with Ind AS, I-GAAP as well as Division I & II respectively of Schedule III of the Companies Act, 2013.

b) Cancellation of lost capital

The entity writes off its fictitious assets or accumulated losses shown as debit balance in P&L Account, by reducing paid-up capital. In such a situation, the accounting entry shall be as follows:

Dr. Equity Share Capital A/C

Cr. Fictitious Assets or Debit balance in P&L Account

c) Cash Payout to shareholders (reduction at par)

When the reduction involves a cash payout to the shareholders, and the reduction is at par, the accounting entry shall be as follow:

Dr. Equity Share Capital A/C

Cr. Bank A/C

d) Cash payout to shareholders (reduction at a premium)

In case reduction is at a premium then the amount of premium paid is debited to Share Premium or Surplus in P&L or Retained Earnings / General Reserves. In such a situation, the additional accounting entry for accounting payment of premium shall be as follows:

Dr. Share Premium / Retained Earnings / General Reserve A/C

Cr. Bank (for the Premium Amount)

e) Distribution in kind

When capital is returned through distribution of non-cash assets such as PPE or investments, the accounting entry shall be as follows:

Dr. Equity Share Capital A/C

Cr. PPE / Investments A/C (at carrying amount)

In case reduction is at a premium, an additional entry will also be passed as follows:

Dr. Share Premium / Retained Earnings / General Reserve A/C

Cr. PPE / Investments A/C (for the Premium Amount)

f) Selective reduction

When the reduction is on selective basis then only the affected shareholders are paid. This involves reducing only the equity held by certain classes of shareholders. Depending on the mode of payment, cash or kind, at par or premium, the accounting entries shall be as follows:

In case of cash pay-out:

Dr. Equity Share Capital A/C

Cr. Bank A/C

In case of reduction in kind:

Dr. Equity Share Capital A/C

Cr. PPE / Investments A/C (at carrying amount)

In case reduction at a premium:

Dr. Share Premium / Retained Earnings / General Reserve A/C

Cr. Bank (by the premium amount) or

Cr. PPE / Investments A/C (by the premium amount)

g) **Capital reduction in amalgamation scheme**

Reduction of share capital may be part of a composite scheme of arrangement, sanctioned by the NCLT under Sections 230 to 232 of the Companies Act, 2013, which may include:

- Amalgamation / merger of companies, and
- Capital reorganization / capital reduction of the transferee company (or transferor), involving accounting treatment as covered herebelow.

4. **Reduction of capital in amalgamated (transferee) company**

Cancellation of existing share capital (e.g. eliminating losses or returning capital). Accounting entries in case of this situation shall be as follows:

1. For cancellation of paid-up share capital:

   Equity Share Capital A/c Dr. Rs. (Face value)

   To Fictitious Assets / Accumulated losses A/c Rs. (Face value)

   (If being set off against Fictitious Assets or accumulated losses)

2. If capital is returned to shareholders:

   Equity Share Capital A/c Dr. Rs. (Face value)

   To Bank A/c Rs. (Amount paid)

   To Share Premium / General Reserve A/c (If at premium)

ADDITIONAL REPORTING REQUIREMENTS UNDER IND AS AND I-GAAP

- Disclosure in notes to accounts: Proper disclosures are essential to show equity movements and preserve clarity in shareholder equity. Nature of reduction, quantum, and class of shareholders affected must be disclosed as per applicable Ind AS, I-GAAP and Schedule III.
- Effect on EPS: Capital reduction may affect equity base. EPS recalculated only if reduction happens mid-year (as per Ind AS 33 and AS 20 if applicable).
- Board and shareholder approvals: Accounting can be recognized only after all legal formalities (including NCLT order) are completed.
- Reserve Usage: Payout beyond face value must be drawn only from free reserves, not revaluation reserves or capital redemption reserves.
- NCLT approval: All reductions under Section 66 must be backed by NCLT approval and reflected in the balance sheet post-reduction date.
- Value measurement: Companies following Ind AS must use fair value measurements where applicable, whereas I-GAAP uses historical cost.

CONCLUSION

Reduction of share capital is more than just a legal step—it has far-reaching tax and accounting implications. From the Income-tax viewpoint, most reductions are treated as transfers, triggering capital gains or loss, and the relevant case laws have firmly established this position. From the accounting standpoint, different types of capital reduction require appropriate journal entries, classification, and disclosures under both Ind AS and Indian GAAP.

Companies and professionals should ensure that legal restructuring through capital reduction is planned with careful tax optimization and transparent financial reporting in mind. Equally, due regard must be given to creditor protection, minority shareholder fairness, and regulatory disclosures under SEBI and Companies Act, 2013.

Both the Income-tax Act and applicable accounting standards view capital reduction as a significant event, with detailed regulatory requirements. While legally permitted under Section 66 of the Companies Act, 2013, it must be carefully planned to avoid adverse tax or financial reporting consequences.

Reduction of capital is not merely a legal action—it is a multi-disciplinary decision involving Board strategy, legal compliance, tax planning, and accounting precision. Companies and professionals must approach it holistically.

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