



Company Law Corner

REGULATORY FRAMEWORK FOR REDUCTION OF SHARE CAPITAL OF COMPANIES

Capital reduction is the process of decreasing a company's share capital (both equity and preference share capital) through share cancellations and share repurchases. The reduction of capital is done by the companies for various reasons, including increasing shareholder value and producing a more efficient capital structure. After a capital reduction, the number of shares in the company will decrease by the reduction amount.

Section 66 of the Companies Act, 2013 was enacted with the intention to allow companies to reduce their share capital in fair and equitable manner and in such a way that reduction does not impact the operations of the company and interest of the creditors remain protected.

❖ **Authorisation for Reduction of Share Capital**

A company limited by shares or limited by guarantee and having a share capital may, reduce the share capital by passing a special resolution, subject to the confirmation by the Tribunal (NCLT) and alter its memorandum by reducing the amount of its share capital and of its shares accordingly. The Tribunal has the absolute power to confirm or reject the scheme of reduction.

❖ **Modes of reduction of share capital**

Section 66(1) of the Companies Act, 2013 does not provide an exhaustive list of means by which share capital can be reduced. It is an inclusive list as indicated by the words "in any manner and in, particular" which gives freedom to the company to adopt any mode of reducing capital. The words "in any manner", gives a wider meaning and there is no limit on the modes in which capital may be reduced.

Reduction of share capital may be effected in one of the following ways:

- (a) Extinguishment or reduction of the liability on any of its shares in respect of the share capital not paid-up.
 - For example: Where the shares are of face value of ₹100 each with ₹75 has been paid, the company may reduce them to ₹75 fully paid-up shares and thus relieve the shareholders from liability on the uncalled capital of ₹25 per share
- (b) Cancel any paid-up share capital, which is lost, or is unrepresented by available assets. This may be done either with or without extinguishing or reducing liability on any of its shares.
 - For example: Where the shares of face value of ₹100 each fully paid-up is represented by ₹75 worth of assets. In such a case, reduction of share capital may be effected by cancelling ₹25 per share and writing off similar amount of assets.
- (c) Pay off any paid-up share capital, which is in excess of the wants of the company. This may be done either with or without extinguishing or reducing liability on any of its shares.
 - For example: Shares of face value of ₹100 each fully paid-up can be reduced to face value of ₹75 each by paying back ₹25 per share.

❖ **Prohibition on Reduction in certain cases**

Reduction shall not be made in the following cases:

- When the company is in arrears of the repayment of any deposits accepted by it, either before or after the commencement of the Companies Act, 2013.
- When the company is in arrears in payment of interest on deposits accepted by it, either before or after the commencement of the Companies Act, 2013.

❖ **Other modes of Reduction of shares capital without Tribunal approval**

Other than Section 66 of the companies Act, 2013, various other provisions under which the capital can be reduced are as follows:

- Where the shares are forfeited for non-payment of call money;
- Where the company buy-back of its own securities by a company under Section 68 of the Companies Act, 2013
- Where redeemable preference shares are redeemed in accordance with the provisions of Section 55 of the Companies act, 2013.

The above provisions are outside the purview of reduction of share capital mentioned under Section 66 of the Companies Act, 2013.

❖ **Reduction of share capital under Section 242 of the Companies Act, 2013**

Apart from reduction of capital under Section 66 of the Companies Act, 2013, there is another circumstance, when share capital can be reduced. In the case of Oppression and Mismanagement, the Tribunal has been given powers under Section 242 of the Companies Act, 2013 to pass an order as it thinks fit which may provide for purchase of shares of any members by the company and consequent reduction of share capital.

❖ **Liability of Members**

A member of the company, past or present, shall not be liable to any call or contribution in respect of any share held by him exceeding the amount of difference, if any, between the amount paid on the share, or reduced amount, if any, which is to be deemed to have been paid thereon, as the case may be, and the amount of the share as fixed by the order of reduction.

❖ **Process of Reduction of Share Capital**

- Convene a Board Meeting
 - To approve the reduction of share capital;
 - To fix the date of general meeting of the company to get approval of members.
- Hold the general meeting and pass Special Resolution approving reduction of share capital.
- File e-form **MGT-14** with ROC within 30 days of passing the Special Resolution.
- Apply to NCLT by filing an application in Form **RSC-1** to confirm reduction of share capital of a company along with prescribed fees. The application shall be accompanied with the following attachments:
 - List of creditors

- Certificate from the auditor of the company to the effect that the list of creditors is correct as per the records of the company verified by the auditor;
 - A certificate by the auditor and declaration by a director of the company that the company is not, as on the date of filing of the application, in arrears in the repayment of the deposits or the interest thereon; and
 - Certificate of auditor that Accounting Treatment proposed by the company for reduction of share capital is in conformity with the Accounting standards.
 - Any other relevant documents.
- The NCLT shall within 15 days of submission of the application give a notice to Central Government, ROC and SEBI in **Form RSC-2** and to every creditors of the company in **Form RSC-3** seeking their representations and objections, if any.
- The notice shall be sent, within 7 days of the direction or such other period as may be directed by the Tribunal, to each creditor whose name is entered in the list of creditors submitted by the company about the presentation of the application and of the said list, stating the amount of the proposed reduction of share capital and the amount or estimated value of the debt or the contingent debt or claim or both for which such creditor's name is entered in the said list, and the time within which the creditor may send his representations and objections.
- Where the name of any creditor entitled to object to the reduction of share capital, by reason of his ignorance of the proceedings for reduction or of their nature and effect with respect to his debt or claim, not entered on the list of creditors, and after such reduction, the company commits a default, within the meaning of section 6 of the Insolvency and Bankruptcy Code, 2016, in respect of the amount of his debt or claim, then:
- (a) every person, who was a member of the company on the date of the registration of the order for reduction by the Registrar, shall be liable to contribute to the payment of that debt or claim, an amount not exceeding the amount which he would have been liable to contribute if the company had commenced winding up on the day immediately before the said date; and
 - (b) if the company is wound up, the Tribunal may, on the application of any such creditor and proof of his ignorance as aforesaid, if it thinks fit, settle a list of persons so liable to contribute, and make and enforce calls and orders on the contributories settled on the list, as if they were ordinary contributories in a winding up.
- The NCLT shall also give direction for the notice to be published in **Form RSC-4** within 7 days of such direction in a leading English and vernacular language newspaper, both having wide circulation in the State in which the registered office of the company is situated, or such newspapers as may be directed by the Tribunal and for uploading on the website of the company (if any) seeking objections from the creditors and intimating about the date of hearing.
- The notice shall state the amount of the proposed reduction of share capital, and the places, where the aforesaid list of creditors may be inspected, and the time as fixed by the Tribunal within which creditors of the company may send their objections.

Provided that the objections, if any, shall be filed in the Tribunal within three months from the date of publication of the notice with a copy served on the company.

- The Company shall file an affidavit in **Form RSC-5** confirming the dispatch and publication of the notice within 7 days from the date of issue of such notice.
- The NCLT may dispense with the requirement of giving notice to the creditors or publication of notice, if every creditor has been discharged or secured or given his consent in writing.
- Representation by Central Government, ROC, SEBI and creditors shall be sent to the NCLT within 3 months of receipt of notice and copy of which shall also be sent to the company. If no such representation has been received by NCLT within the said period, it shall be presumed that they have no objection to the reduction.
- Company shall send the representation or objections so received along with responses of the company thereto to the NCLT within 7 days of expiry of period upto which objections were sought.
- NCLT may hold any enquiry on adjudication of claim and/or give direction for securing the debts of the creditors.
- The Tribunal may, if it is satisfied that the debt or claim of every creditor of the company has been discharged or determined or has been secured or his consent is obtained, make an order confirming the reduction of share capital on such terms and conditions as it deems fit.
- The order confirming the reduction of share capital shall be in Form **RSC-6**.
- The order of confirmation of the reduction of share capital by the Tribunal shall be published by the company in such manner as the Tribunal may direct.
- The company shall deliver a certified copy of the order of the NCLT and of minute approved by the Tribunal to the ROC showing—
 - (a) the amount of share capital;
 - (b) the number of shares into which it is to be divided;
 - (c) the amount of each share; and
 - (d) the amount, if any, at the date of registration deemed to be paid-up on each share, and file E-form **INC-28** within 30 days of the receipt of order.
- The ROC shall issue a certificate to that effect in Form **RSC-7**.

❖ **Additional compliance by a Listed Company**

In case a listed entity is in the process of implementation of any scheme with respect to reduction of capital they have to comply with various provisions under SEBI (LODR) Regulations, 2015.

➤ **Regulation 11- Scheme of Arrangement**

The listed entity shall ensure that any scheme of arrangement /amalgamation/merger /reconstruction /reduction of capital etc. to be presented to any Court or Tribunal does not in any way violate, override or limit the provisions of securities laws or requirements of the stock exchange(s).

➤ **Regulation 37- Draft Scheme of Arrangement & Scheme of Arrangement**

Without prejudice to provisions of regulation 11, the listed entity desirous of undertaking a scheme of arrangement or involved in a scheme of arrangement, shall file the draft scheme of arrangement, proposed to be filed before any Court or Tribunal under sections 391-394 and 101 of the Companies Act, 1956 or under Sections 230-234 and Section 66 of Companies Act, 2013, whichever applicable, along with a non-refundable fee as specified in Schedule XI, with the stock exchange(s) for obtaining Observation Letter or No-objection letter, before filing such scheme with any Court or Tribunal, in terms of requirements specified by the Board or stock exchange(s) from time to time.

The listed entity shall not file any scheme of arrangement under sections 391-394 and 101 of the Companies Act, 1956 or under Sections 230-234 and Section 66 of the Companies Act, 2013, whichever applicable, with any Court or Tribunal unless it has obtained observation letter or No-objection letter from the stock exchange(s).

The listed entity shall place the Observation letter or No-objection letter of the stock-exchange(s) before the Court or Tribunal at the time of seeking approval of the scheme of arrangement.

Further, the validity of the 'Observation Letter' or No-objection letter of stock exchanges shall be six months from the date of issuance, within which the draft scheme of arrangement shall be submitted to the Court or Tribunal. The listed entity shall ensure compliance with the other requirements as may be prescribed by the Board from time to time.

Upon sanction of the Scheme by the Court or Tribunal, the listed entity shall submit the documents, to the stock exchange(s), as prescribed by the Board and/or stock exchange(s) from time to time.

➤ **Regulation 28(2) - In-principle approval of recognized stock exchange(s)**

The requirement of obtaining in-principle approval from recognised stock exchange(s), shall not be applicable for securities issued pursuant to the scheme of arrangement for which the listed entity has already obtained No-Objection Letter from recognised stock exchange(s) in accordance with regulation 37.

❖ **Reduction of Share Capital vis-a-vis FEMA**

Transfer of shares by a non-resident to an Indian company under buyback and/or capital reduction scheme of the company require to comply with the provisions of Foreign Exchange Management Act, 1999, Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 read with Foreign Direct Investment (FDI) Policy 2020.

❖ **Whether Reduction of Share Capital and Diminution of Share Capital same?**

Diminution of capital is the cancellation of the unsubscribed part of the issued capital.

As per Section 61(1)(e) of the Companies Act, 2013, provides that, a limited company having share capital, if authorised by its Articles of Association, may cancel shares, by passing an ordinary resolution in that behalf, which have not been taken or agreed to be taken by any person, and diminish the amount of its share capital by the amount of the shares so cancelled. Diminution of Capital do not require confirmation by the Tribunal.

Further, Section 61(2) of the Companies Act, 2013 specifically states that the cancellation of shares under section 61(1) of the Companies Act, 2013 shall not be deemed to be reduction of share capital.

❖ **Buyback of Shares vs. Reduction of Share Capital**

Reduction of Share Capital under Section 66 of the Companies Act, 2013 has the effect of reducing the subscribed and paid-up capital of the company as a result of that either the face value of the shares undergoing the reduction gets reduced or the shares are completely extinguished. It is not different from the result of buyback of shares. Buyback of shares are alternate to reduction without involvement of NCLT procedure. This is the reason Section 66(6) of the Companies Act, 2013 specifically mentioned that this section shall not apply to buyback of its own securities by a company under Section 68 of the Companies Act, 2013.

Further, the intention of regulator seems to be that if buyback is made in strict compliance with the provisions of Section 68 of the Companies Act, 2013, then the provisions of Section 66 of the Companies Act, 2013 will not apply to such buy-back.

❖ **Offences and Compoundability**

If any officer of the company—

- (a) knowingly conceals the name of any creditor entitled to object to the reduction;
- (b) knowingly misrepresents the nature or amount of the debt or claim of any creditor;
or
- (c) abets or is privy to any such concealment or misrepresentation as aforesaid, shall be liable under section 447 of the Companies Act, 2013.

❖ **Judicial Elucidations:**

- 1) *Indian National Press (Indore) Ltd., In re, (1989) 66 Com Cases 387, 392 (MP)*- The need for reducing capital may arise in various ways, for example, trading losses, heavy capital expenses, and assets of reduced or doubtful value. As a result, the original capital may either have become lost or a company may find that it has more resources than it can profitably employ. In either case, the need may arise to adjust the relation between capital and assets.
- 2) *Birla Global Finance Ltd., in re:* In this case the court held that the redemption of preference shares is nothing but repayment of the preference capital and amounts to reduction of share capital.
- 3) *Sandvik Asia Ltd. v. Bharat Kumar Padamsi:* Here the court held that once it is established that non-promoter shareholders are being paid fair value of their shares, and an overwhelming majority of them have voted in favour of resolution for reduction of share capital, the court will not be justified in withholding the sanction to the resolution.
- 4) *Elpro International Ltd.:* The Bombay High Court while dealing with a special resolution passed in favour of reduction of capital, held that a company can reduce the share capital of any shareholder in any way so long as the procedure is fair and gets the approval of the majority shareholders.

- 5) *In the matter of Josco Jewellers Private Limited:* The Petitioner Company had filed a petition under Section 66 of the Companies Act, 2013 against the Registrar of Companies, Kerala seeking reduction of its share capital from Rs. 120 crores to Rs. 1 crore. After a review of the capital structure, the Board of Directors of the Petitioner Company observed that the company's paid up capital was more than the required amount for the existing business of the company and that it would be beneficial for the company to remit back its excess capital by way of reduction of share capital. The NCLT, Kochi Bench held that since all the requisite statutory procedures have been fulfilled and no objections has been received from any shareholders, the company petition filed for reduction of its share capital is hereby allowed.
