



NEWSLETTER

November 2022

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REDUCTION OF SHARE CAPITAL

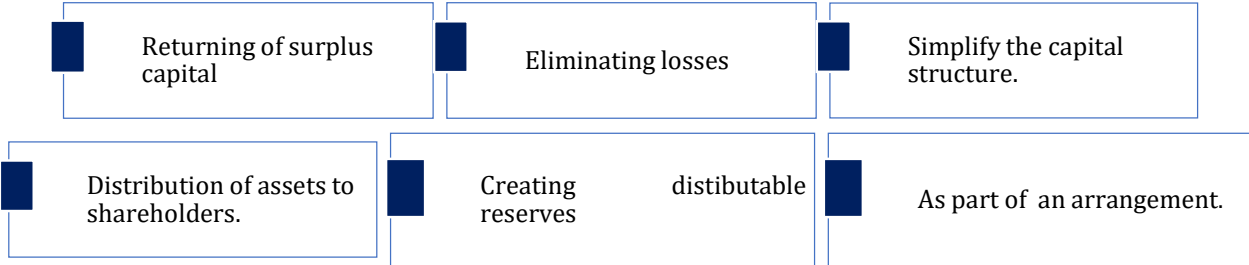
- SECTION 66 OF COMPANIES ACT, 2013

What is Reduction of Capital?

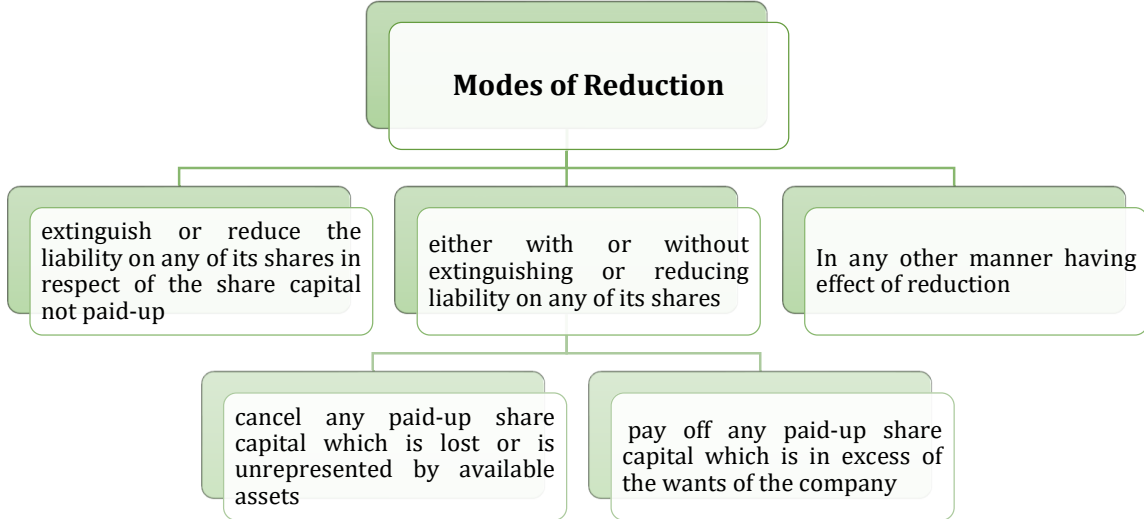
Reduction of Share Capital means reduction of issued, subscribed and paid-up share capital of the company.

Section 66 of the Companies Act, 2013 provides that, subject to authorization by a special resolution and approval of the National Company Law Tribunal (“NCLT”) on an application, a company may reduce the share capital “in any manner”, including paying-off any share capital “which is in excess of the wants of the company”.

Objectives



Modes of Reduction of Capital



Modes of Reduction of Capital

OTHER MODES OF REDUCTION	Cancellation of all the share capital as a part of scheme of arrangement.
	Utilizing SPA other than for the purposes specified under Section 52(2) { Reduction at premium out of SPA; Set-off of SPA against revenue losses.
	Cancellation of Shares surrendered.
	Writing-off unpaid capital

Conditions for Reduction of Capital

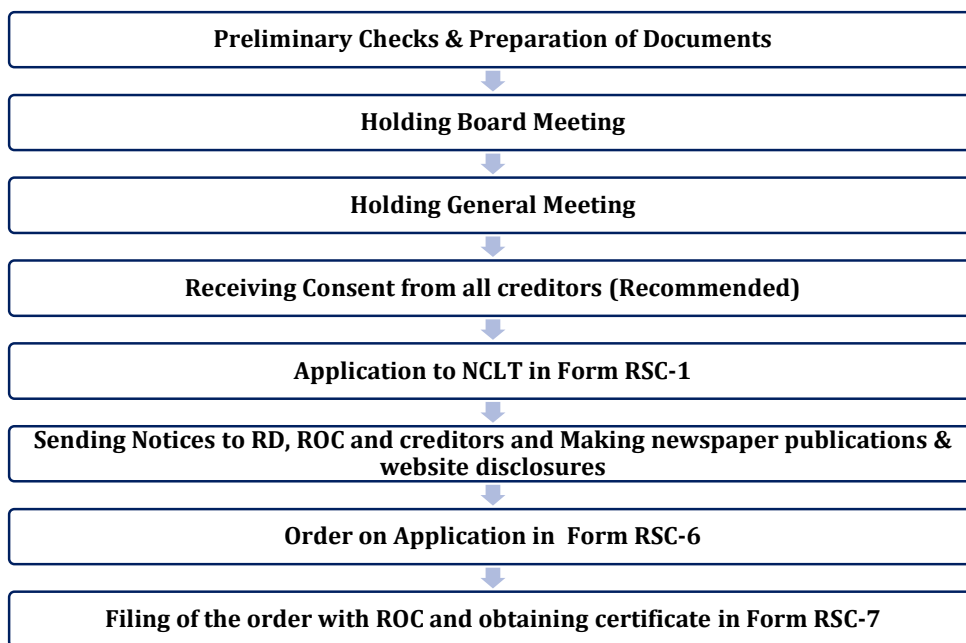
No arrears in the repayment of Deposits and Interest thereon.

Application to be made to the National Company Law Tribunal.

Accounting treatment proposed for reduction to be in conformity with the Accounting Standards.

Debt or claim of every creditor has to be discharged or secured or his consent should be obtained before sanctioning such reduction of capital.

Steps for Reduction of Capital



What is not considered as reduction?

- Diminution of Share Capital – Cancellation of unsubscribed part of issued capital.
- Where redeemable preference shares are redeemed in accordance with the provisions of sections 55
- Where company purchases its own shares in pursuance of provisions of Section 68.
- Purchase of Shares of a member by company on order of tribunal under section 242 or sanctioning any compromise or arrangement under Section 230 of Companies Act, 2013
- Where any shares are forfeited for non-payment of calls and such forfeiture amounts to reduction of capital

*** In all these cases, procedure for reduction of capital under section 66 is not attracted.**



Case Law – Selective Reduction

XYZ Private Limited Vs ROC, Karnataka ; RD, South east Region

Appellant – XYZ Private Ltd, Respondents – ROC, RD

Brief Facts of the Case:

1. Proposed reduction of capital by the company was selective, which involved repayment of excess capital which was not required.
2. The reduction was proposed to be made from non-promoter equity Shareholders at a premium of Rs. 5.27/- per share (Face value being Re. 1/-) to be paid out of securities premium account.
3. Tribunal directed to issue notices to ROC, RD, make newspaper publication.

Observations made by ROC & RD:

1. The company need to extend scope to all shareholders.
2. The SPA can be utilized only for conditions provided in Section 52(2) of the Act.
3. As per the scheme, the amount to be paid shall be kept in escrow a/c and amount unpaid shall be transferred to IEPF, which cannot be done as per Section 125.
4. Company ought to have opted for buyback instead of going for reduction of capital.

Grounds for dismissal of application:

1. No proper genuine reason has been given for reduction of share capital and there is no accumulated loss.
2. Consent affidavit from creditors has not been obtained.
3. Security Premium Account cannot be utilized for making payment to the non-promoter shareholders.
4. Consent from 171 non-promoters' shareholders who were not traceable, has not been obtained and claim of such shareholders has not been secured or determined.
5. Selective reduction of shareholders is not permissible.
6. The Petition for reduction of capital under Section 66 of the Act, is not maintainable. However, it may be filed under Section 230-232 of the Act.

NCLAT set aside the order the NCLT saying the order passed by the tribunal are on erroneous ground, not tenable and set aside the impugned order passed by tribunal and confirmed the reduction of capital

Can a Company with negative net-worth go for reduction of capital?

Precious Energy Services Ltd Vs Regional Director

In the above case, Reduction of Capital was approved unanimously by way of a Special Resolution with the objective of reducing the overall weighted average cost of Capital and improving the earnings per share.

All the requirements under section 66 were satisfied, despite the approval being given by all shareholders, NCLT had erroneously rejected the same though it was not in violation of the Act.

The NCLAT held that *“The question of reduction of share capital is treated as matter of domestic concern, i.e. it is the decision of the majority which prevails. If majority by special resolution decides to reduce share capital of the Company, it has also the right to decide as to how this reduction should be carried into effect....”*

Buy Back of Securities

Section 68 of Companies Act, 2013

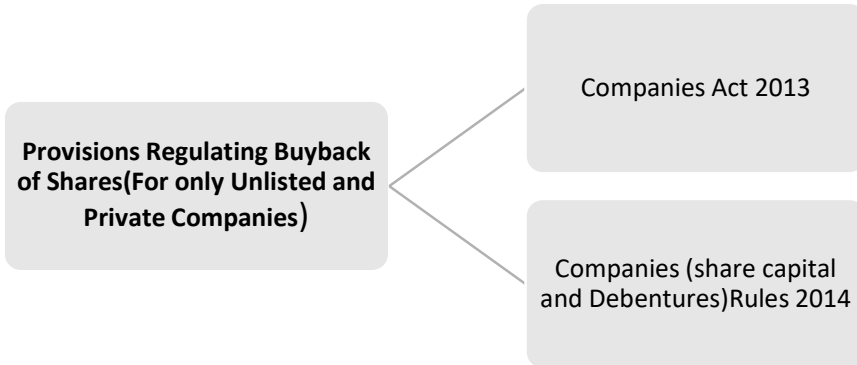
Introduction

- The provisions of buy-back of shares were introduced w.e.f. 31-10-1998 in the Companies Act, 1956, SEBI regulations 1999.
- Section 68 of the Companies Act, 2013 gives power to company to purchase its own shares and other specified securities.
- It is a process by which a cash-rich company purchases and cancels some of its outstanding equity share.

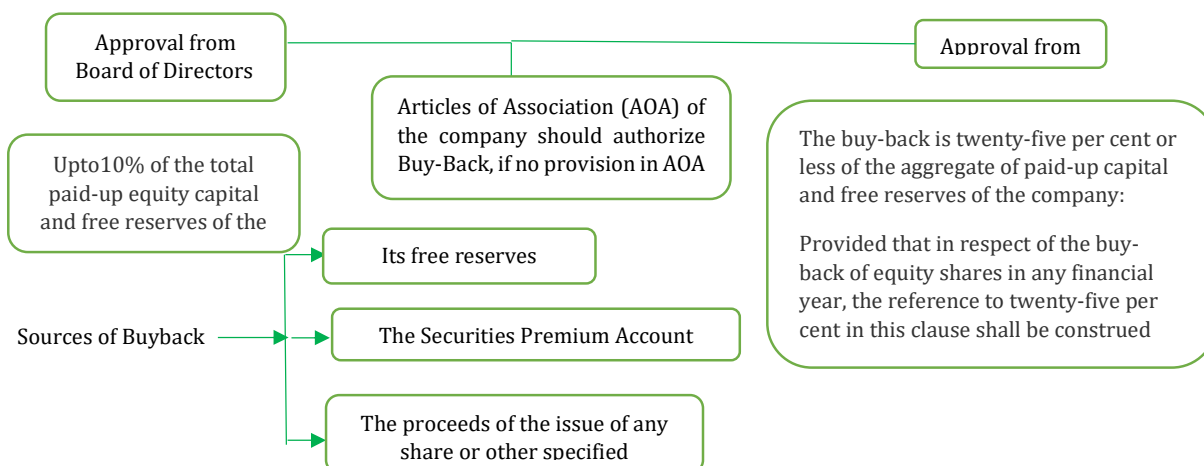
Reasons why company does buy back

- Increases company's EPS
- Provide Fund to the Shareholders instead of Dividends
- Protects company from Hostile takeovers
- Maintain the Debt-Equity Ratio
- Increases the ROC and ROI
- Services the Equity more Effectively
- Reduces the share capital of Company

Legal Frame Work



AUTHORIZATION AND QUANTUM OF BUYBACK

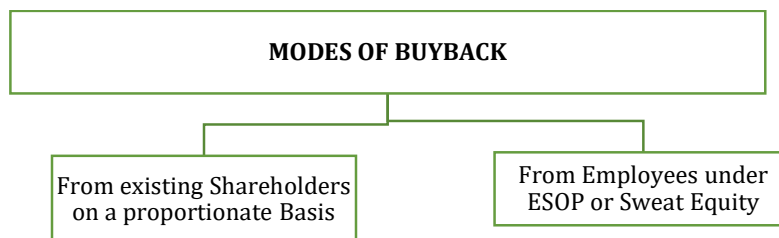


***Provided that no buy-back of any kind of shares or other specified securities shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.**

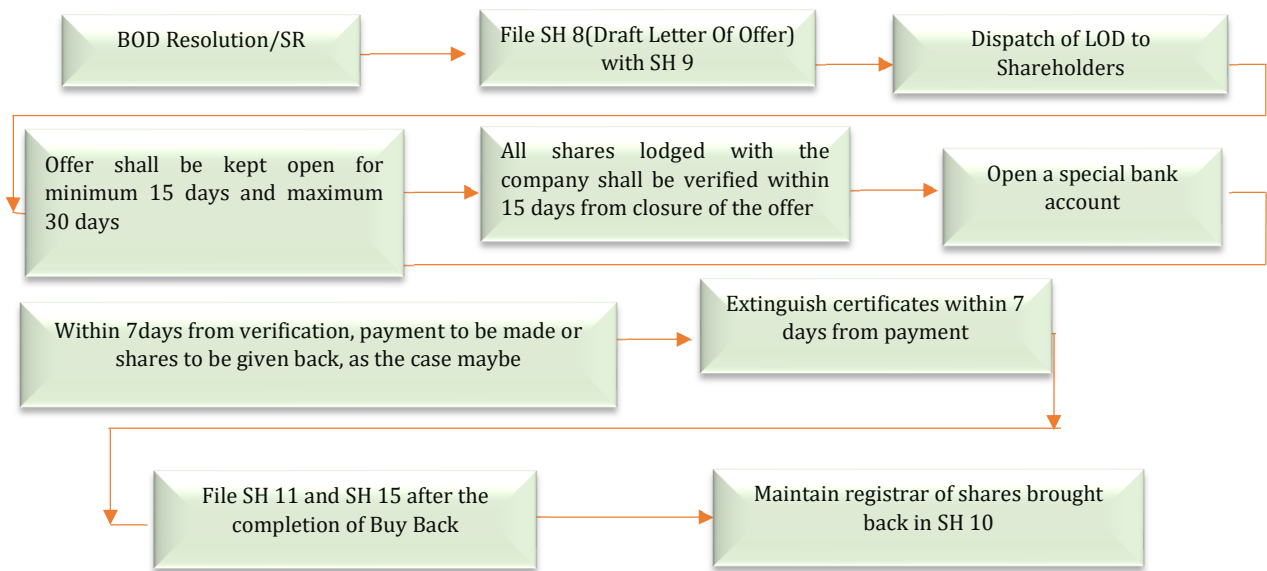
The Company shall ensure the following in the Buy Back Process

The Company shall not issue any **new shares** including bonus shares from the date of passing special resolution till the date of closure of the offer for buy back

1. The Company shall confirm in its offer the opening of a **separate bank account** for the purpose of meeting its payment obligations.
2. The company shall **not withdraw** the offer once it has announced it to the shareholders.
3. The company shall **not utilize any borrowed** money from banks/ financial institutions for the purpose of buy back.
4. The company shall **not utilize the proceeds of an earlier issue of same kind of shares/securities** for the buy back.
5. The company after the completion of buy back shall not make further issue of **same kind of shares/other securities** including by way of rights issue within a period of 6 months **except** by way of bonus issue, conversion of warrants, stock options schemes, sweat equity or conversion of preference shares or debentures into equity.
6. In the case of buy back of equity shares only, the buy back in **any financial year shall not exceed 25% of the paid up equity capital**
7. Debt-Equity Ratio post buy back $\leq 2:1$
8. All securities are **fully paid up**



Procedure for Buy-back of shares for unlisted Companies



PURPOSE	FORMS	DURATION
Board Resolution (only for public & Listed Companies)	MGT-14	30 Days from BM
Special Resolution	MGT-14	30 Days from GM
Letter of Offer (only if buy back is approved pursuant to Special Resolution)	SH-8	
Declaration of solvency (only if buy back is approved pursuant to Special Resolution)	SH-9	Along with Letter of Letter
Return of Buy Back	SH-11	30 Days from completion of Buy back

Restriction on Buy-back

According to section 70 of the Companies Act, 2013, A Company should not buy-back its securities or other specified securities, directly or indirectly –

- Through any subsidiary including its own subsidiaries; or



- Through investment or group of investment Companies; or
- When Company has defaulted in repayment of deposits or interest payable thereon, or in redemption of debentures or preference share or repayment of any term loan.

The prohibition is lifted if the default has been remedied and a period of 3 years has elapsed after such default ceased to subsist.

- When Company has defaulted in filing of Annual Return, declaration of dividend & financial statement.

Punishment:

If a company makes any default in complying with the provisions of Section 68, then the punishment shall be as follows: Company and officer in default: punishable with fine which shall not be less than 1lakh but which may extend to 3 lakh rupees.

Tax Aspects

The provisions of Income Tax with regard to buyback of shares are covered under Sec 115 QA of the Finance Act, 2013 which applied to only unlisted companies which warranted a tax of 20% on the distributed income. (i.e.23.296% (20% + 12% SC + 4% H&EC)

The rationale for the introduction of the provision was that unlisted companies resorted to buyback of shares in order to avoid dividend distribution tax.

In the hands of shareholders it is exempted under Section10(34A) of Income Tax Act.

As the buyback was charged as capital gains in the hands of the shareholder and dividend distribution tax was charged to the company. Therefore the amendment was introduced as an anti-tax avoidance measure.

The Union Budget 2019 announced the said section to be applicable to the listed companies as well. The amendment is effective for all buybacks post-July 5, 2019, vide Finance Act (No.2) 2019.

Valuation Aspects

UNLISTED COMPANIES		
Tax	Company law	FEMA
<ul style="list-style-type: none"> • No Methodology prescribed • Reference check to Rule 11 UA valuation/ Fair Market Valuation principles to be kept in reckoning from a good governance perspective • Transfer pricing- Fair value considerations to be borne in mind and taken into account 	<ul style="list-style-type: none"> • No Methodology prescribed • Generally, will be Fair Market value • A disclosure of the basis of arriving at a buy back price is required for which ordinary a valuation report may be obtained. 	<ul style="list-style-type: none"> • Pricing guidelines to be adhered to • Listed company- The price worked out in accordance with the relevant Securities and Exchange Board of India guidelines-typically the Preferential allotment guidelines • Unlisted Company-The valuation of equity instruments done as per any Internationally accepted pricing methodology for valuation on an arm's length basis duly certified by Chartered Accountant or a Merchant Banker registered with Securities and Exchange Board of India or a practicing Cost Accountant

Industrial Perspective

Report of Company Law Committee 2022:

The 3rd report of the Company Law Committee (2022) (CLC-2022) submitted on 21st March 2022 has recommends various changes to the Companies Act, 2013. It also Clarified the provisions on buy-back of securities.

Observation and Recommendations of the Committee:

- Free reserves should be explicitly included in calculating the buy-back of equity shares.
- For companies that grant stock options (such as ESOPs), only those options, which the shareholders have exercised, can be bought back by the company.

Proposed Amendments:

- Amendment to the proviso to Section 68 (2) to explicitly include 'free reserves' while calculating the threshold of twenty-five per cent in case of buy-back of equity shares.
- Amendment to the Explanation to Section 68 clarifying that only those stock options which have been exercised can be bought back by the company.

Recently Announced Buy Back

- Recently Companies like Infosys Limited, Tanla Platforms Limited, ACC Limited Mindteck (India) Limited are in a process of Buy Back of their shares.

CASE LAWS

Capgemini India Private Limited – Buyback of Shares Evasion of Tax

Facts:

The taxpayer company, Capgemini India Private Limited, had filed Petition with the High Court for seeking sanction of the Scheme of Arrangement ("Scheme") entered with its equity shareholders for buyback of its shares which represented 30% of the issued, subscribed and paid up share capital.

- The Scheme was drawn in accordance with the provisions of section 391 read with sections 100 to 103 of the 1956 Act.
- The Petition was admitted by the High Court.
- The Regional Director raised objections and opposed the sanction of the Scheme on the contention that the buyback of shares must be effected only under Section 77A of the 1956 Act / Section 68 of the 2013 Act and that if the Scheme is sanctioned under section 391 read with section 100 to 103 of the 1956 Act, it would result in evasion of income tax and outflow of foreign exchange to the tune of INR.2.48 billion. According to the Regional Director, the taxpayer is not following the procedure prescribed under section 77A of the 1956 Act / section 68 of the 2013 Act to evade tax liability on the distributed income as provided in section 115QA1 of the Act

Issue: Whether the Petition filed in relation to Scheme with the equity shareholders for buyback of shares of the taxpayer company should be sanctioned keeping in mind the contentions raised by the Regional Director?

Judgement:

- The High Court sanctioned the scheme but with a clarification that the issues relating to income tax that may arise out of the Scheme are left open to be dealt with and decided by the Income-tax Authorities in accordance with law

- The Bombay High Court has upheld its earlier decision that it is not necessary that buyback should be undertaken only by following the procedure laid down under section 77A of the 1956 Act 1956 (now section 68 of the 2013 Act). The buyback is also permissible to be undertaken by following the procedures laid down under section 391 read with sections 100 to 104 of the 1956 Act (now section 230 read with section 66 of the 2013 Act). Further, the issue whether buyback under section 391 of the 1956 Act will result in any tax liability under section 115QA of the Income Tax Act, 1961 has been left open to be dealt with by income tax authorities in accordance with law.

Sanjeev Suri & Anr.Vs. Hansa Agencies Pvt. Ltd. & Ors.

Judgement:

- ✚ On 29th August, 2018, when this Appellate Tribunal issued notice on Respondents directed them to state whether any special resolution has been passed in the General Meeting of the Company authorizing 'buy back shares' in terms of Section 68(2)(b) of the Companies Act, 2013 or not. This Appellate Tribunal also passed interim order to the following effect: -

"In the meantime, if any decision is taken in the Extra Ordinary General Meeting of the Company on 29th August, 2018 or thereafter to buy back shares of shareholders of the company, such decision should not be given effect without the prior permission of this Appellate Tribunal.

- ✚ Mr. Rohit Sharma, learned counsel appearing on behalf of the Respondent submitted that no specific resolution has been taken in the General Meeting of the Company authorizing buy back shares in terms of Section 68(2)(b) of the Companies Act, 2013. In the Extraordinary General Meeting held on 29.08.2018, no such decision on buy back of the shares has been taken.
- ✚ Having heard learned counsel for the parties, we are not inclined to pass any specific order. We make it clear that if any decision is taken by Respondent for buy back of the shares of shareholders of the company, it should be taken in terms of the provisions of the Companies Act, 2013 including Section 68(2)(b).
- ✚ In such case, it will be open to the Appellant to take its stand in the meeting. The parties should ensure that the petition pending before the Tribunal is decided on an early date without asking for unnecessary adjournment. The appeal stands disposed of with aforesaid observations. No cost.\

Compliances – Unlisted Company Vs Listed Company

Parameters	Share Buy Back Private Company/Unlisted Company	Share Buy Back Listed Company
Legal Framework	<ul style="list-style-type: none"> • Section 68, 69 and 70 of the Companies Act, 2013. • Rule 17 of the Companies (Share Capital and Debentures) Rules, 2014 	<ul style="list-style-type: none"> • SEBI (Buy-Back of Securities) Regulations, 2018. • Section 68, 69 and 70 of the Companies Act, 2013. • Rule 17 of the Companies (Share Capital and Debentures) Rules, 2014.
Modes of Buyback	<ul style="list-style-type: none"> • From existing Shareholders on a proportionate Basis • From Employees under ESOP or Sweat Equity 	<ul style="list-style-type: none"> • From existing Shareholders on a proportionate Basis • From Employees under ESOP or Sweat Equity • Tender Offer • Open Market • Odd lot holders

Taxation	<ul style="list-style-type: none"> Company has to pay tax on buyback @20% (i.e.23.296% (20% + 12% SC + 4% H&EC) Amount Received in the hands of shareholder is exempted under Section10(34A) of Income Tax Act. 	<ul style="list-style-type: none"> Company has to pay tax on buyback @20% (i.e.23.296% (20% + 12% SC + 4% H&EC) Amount Received in the hands of shareholder is exempted under Section10(34A) of Income Tax Act.
Valuation	<ul style="list-style-type: none"> No methodology prescribed for fixing the Buy-Back price but generally will be the Fair Market Value as per International Valuation Standards. Ordinarily a valuation report obtained from a Registered Valuer. 	<ul style="list-style-type: none"> No methodology prescribed under SEBI Regulations for listed companies, however the board needs to determine a fixed price in a tender offer or a maximum price in case of open market operations
Publication in Newspaper	<ul style="list-style-type: none"> Publication in Newspaper is not required. 	<ul style="list-style-type: none"> The company shall make a public announcement within two working days from the date of declaration of results of the postal ballot in at least one English National Daily, one Hindi National Daily and one Regional language daily, all with wide circulation at the place where the Registered Office is situated along with all the material information as specified in Schedule I
Merchant Banker	<ul style="list-style-type: none"> Not required to appoint a Merchant Banker 	<ul style="list-style-type: none"> Merchant Banker is required to handle the process of Buyback

Distinction - Reduction of Capital and Buyback of Shares

Parameters	Reduction of Capital	Buy Back of Shares
Scope	<ul style="list-style-type: none"> Wide; to cover reduction of Capital, Securities Premium Account 	<ul style="list-style-type: none"> Narrow; to cover buy-back of shares and ESOP grants.
Restrictions on Size	<ul style="list-style-type: none"> No restriction 	<ul style="list-style-type: none"> Restriction upto 25% of paid up capital and free reserve
Regulatory process/Approvals	<ul style="list-style-type: none"> SEBI, SE, RBI, Lenders and NCLT. 	<ul style="list-style-type: none"> Board of Directors approval and under section 68 of the Companies Act, Special Resolution subject to limitations of quantum and Compliance with SEBI Regulations.
Time-period	<ul style="list-style-type: none"> No restriction on completing the process of reduction of capital within specific time period. 	<ul style="list-style-type: none"> Every buy-back shall be completed within a period of one year from the date of passing of the special resolution.

Compliance Calendar



Companies Act, 2013			
Compliance details	Form	Applicability	Due Date
Reconciliation of Share Capital Audit Report	Form PAS-6 (Half Yearly)	Every unlisted public company	29/11/2022
Filing of Annual Return with Registrar	Form MGT-7/7A	Every Company	29-11-2022 /60 days from the date of AGM
FEMA			
Compliance details	Form	Applicability	Due Date
External Commercial Borrowings (ECB) - FEMA	Form ECB-2	All Companies having ECB	07/11/2022
SEBI LODR Regulations			
Compliance details	Form	Applicability	Due Date
Regulation 33	Financial Results along with Limited review report/Auditor's report	All Listed Entity	14/11/2022
Labour Laws			
Compliance details	Form	Applicability	Due Date
PF Payment	Monthly ECR	Entities registered with PF Authorities	15/11/2022
ESI Payment	Monthly ECR	Entities registered with ESIC Authorities	15/11/2022
INCOME TAX			
Compliance details	Form	Applicability	Due Date
TDS Payment	Challan 281	Non-government deductors	07/11/2022
GST			
Compliance details	Form	Applicability	Due Date
Return of outward supplies of taxable goods and/or services	GSTR 1	GST Taxpayers who have not opted for QRMP scheme	11/11/2022
Return of outward supplies of taxable goods and/or services	GSTR 1	GST Taxpayers who opted for QRMP scheme - Optional	13/11/2022
Summary Return of Outward and Inward Supplies along with payment of Tax	GSTR 3B	GST Taxpayers who have not opted for QRMP scheme	20/11/2022
GST Challan Payment if no sufficient ITC		GST Taxpayers who opted for QRMP scheme and not having sufficient ITC	25/11/2022
Summary Return of Outward taxable supplies and tax payable	GSTR 5 & 5A	Non Resident GST Taxpayers	20/11/2022
Return for details of ITC received and distribution	GSTR 6	Input Service Distributors	13/11/2022
Return for TDS under GST	GSTR 7	Government Authorities	10/11/2022
Return for Details of Supplies and the amount of tax collector	GSTR 8	E-commerce Operator	10/11/2022
Return for details of goods and services purchased in India	GSTR-11	Taxpayer claiming Refund & having UIN	28/11/2022