Share Capital

Subject : Commerce

Lesson: Share Capital

Course Developer : Dr. Shuruti Mathur, Assistant Professor

College/ Department: Motilal Nehru College, University of Delhi

Table of Contents

- Unit 4 :Share Capital
  - Introduction
  - 4.1. Type of Shares
  - 4.2. Distinction Between Share and Stock
  - 4.3 Issue Of Shares
  - 4.4 Allotment of Shares
  - 4.5 Forfeiture of Shares
  - 4.6 Transfer / Transmission of Shares
  - 4.7 Dividend
  - Section
  - Summary

Share Capital

Introduction

A company is formed through the stages of promotion, incorporation, capital subscription and finally commencement of business 1 . To start its operations, a company needs to raise funds. Funds are the lifeline for any organization. Capital may be raised by issuing shares or debt. Issuing shares is an important way of raising long-term finance for business. This is also known as equity finance. The main advantage of equity finance is that the company does not necessarily have to repay the finance or pay interest, as is the case of bonds, bank loans or overdraft.

This lesson discusses the concept and various aspects of shares. The first section defines what a share is and the various types of shares that can be issued by the company. The second section differentiates between share and stock. The next two sections elaborate the terms of issue and allotment of shares. The lesson also explains other concepts related to shares such as forfeiture, calls, surrender, transfer, transmission etc. In the last section, the concept and provisions related to dividend are discussed.

Share Capital

4.1. Type of Shares

What is Share?

Shares in a company represent ownership. Shares are a type of securities of section 2 of the Securities Contracts (Regulation) Act, 1956. Thus, securities include not only shares but also scrips, stocks, bonds, debentures, derivatives, units under any mutual fund scheme etc. For details refer to http://www.sebi.gov.in/acts/contractact.pdf (date: 19-02-2010, 20:35)" alt="According to Section 2 [(45AA)] of Companies Act, 1956, Securities means securities as defined in clause of section 2 of the Securities Contracts (Regulation) Act, 1956. Thus, securities include not only shares but also scrips, stocks, bonds, debentures, derivatives, units under any mutual fund scheme etc. For details refer to http://www.sebi.gov.in/acts/contractact.pdf (date: 19-02-2010, 20:35)">2 .When an individual buys shares in a company, he / she becomes one of the owners of the business. This entitles him / her to a share of the distributable profits of the company.

As per Section 2 (4 6) of the Companies Act, 1956 " 'share' means share in the share capital of a company". So a share basically refers to a unit or part of the share capital which is issued by the company.In its decisions on some

Figure 4.1 Part Ownership

important cases the Supreme Court has elaborated that a share represents more than just money. Two such decisions are mentioned below.

CASE LAW 1
Commissioner of Income Tax v. Standard Vacuum Oil[4]

In this case, it was held that a share is meant as the interest measured by a sum of money and made up of diverse rights conferred on its holder which constitute a contract between him and the company.

CASE LAW 2

Bucha F. Guzdar v. Commissioner of Income Tax, Bombay[3]

In this case, the court observed that a share is "a right to participate in the profits made by a company, while it is a going concern and declares a dividend, and in the assets of the company when it is wound up.

Thus, a share is something more than a sum of money or a piece of paper issued by the company. It is a bundle of rights and obligations. A share makes its holder a member of the company and bestows on him / her the right to receive a share of the company's profits and assets. The shareholder is also under obligation to pay to the company the amount of money at which the share is issued (as and when the company calls for the money) and/or any sum guaranteed by him / her. The shares are evidenced by the share certificates which can be transferred from one person to the other. Nowadays, shares are transferred in demat form [5] .

Types of Shares

According to section 86, the share capital of a company limited by shares [6] can be of two kinds:
4.1.1 Equity share capital
(i) With voting rights; or
(ii) With differential rights [7] as to dividend, voting or otherwise in accordance with such rules and subject to such conditions as may be prescribed.
4.1.2 Preference share capital
(i) Cumulative and Non-cumulative Preference Shares

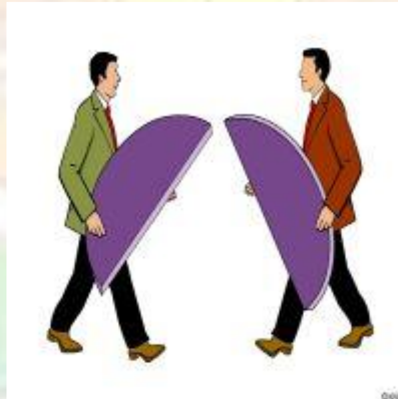
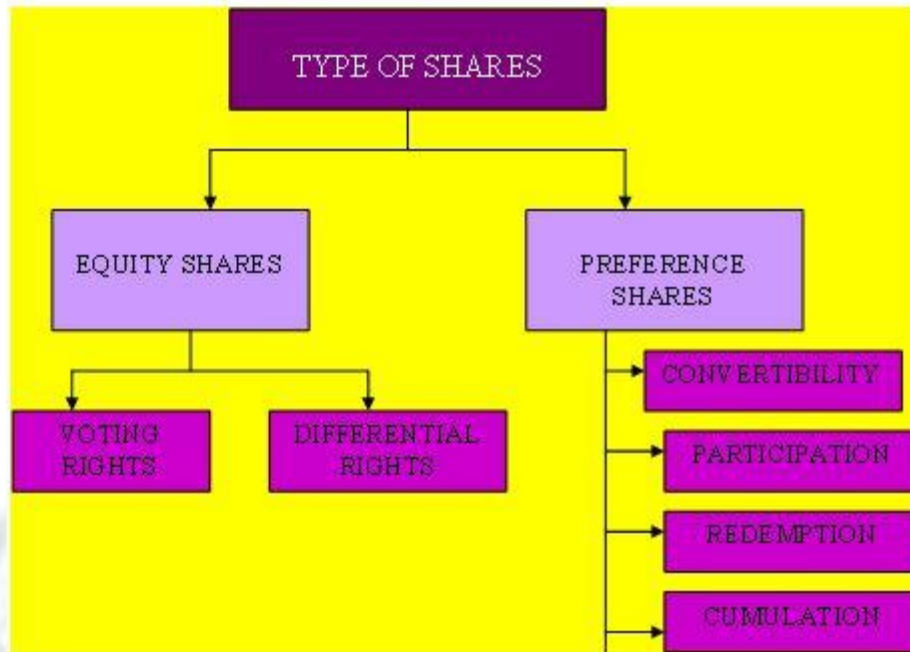


Figure 4.2 Equity & Preference

(ii) Redeemable and Irredeemable Preference Shares
(iii) Participating and Non-Participating preference shares
(iv) Convertible and Non – Convertible preference shares

Fig 1- Type of Shares



These two types of shares are discussed below

4.1.1 Equity Shares

According to Section 85, all share capital which is not preference share capital is equity share capital. Thus all those shares which are not entitled to a preferential payment of dividends as well as repayment of capital are termed as equity shares. Thus, if a company wants to pay dividends or is wound up, it must first meet the claims of the preference shareholders and only after that can it make payments to its equity shareholders. Equity shareholders are entitled to residual profits. The two types of equity shares are:

1. Equity Shares with Voting rights: According to Section 87 of the Companies Act, 1956, every shareholder of a company has a right to vote on every resolution put before the company, and his / her voting right in case of polling are proportional to the amount of share capital held by him / her.

Figure 4.3 Voting Rights

Illustration :

Priya is a shareholder in Sugandh Perfumes Ltd., which has a share capital of Rs 1,00,00,000. She holds equity shares with voting rights in the company worth Rs 10,00,000. A poll takes place in a general meeting on an important issue. Her votes carry 10% weight in the decision making.

2. Equity Shares with Differential rights: After the Companies (Amendment) Act, 2000, a company can issue equity shares with "differential voting rights" in regard to dividend and voting. The Companies (Issue of Share Capital with Differential Voting Rights) Rules, 2001 specifies that for doing so the certain conditions have to be satisfied. The company should have distributable profits and should not have failed to file annual returns for three previous financial years. The company should have repaid all its deposits and interest and redeemed its debentures on the due date. The company should not have been convicted for anything under SEBI, SCRA or FEMA regulations. The issue of such shares must be authorized by the articles of the company and a resolution of shareholders. Further, the company is not allowed to convert its equity capital with voting rights into equity share capital with differential voting rights or vice versa. The proportion of this type of share capital cannot exceed 25% of the total share capital issued by the company.

Those shares which are entitled to a preferential payment of dividends as well as repayment of capital are termed as preference shares (Section 85). There are many ways to classify preference shares. The common types of preference shares are:

1. Cumulative and Non-Cumulative Preference Shares: This classification is made on the basis of whether the dividend (if not paid in a particular year) accumulates over time or not. In the former case, the shares are said to be cumulative preference shares while in the latter case they are called non-cumulative.

Figure 4.4 Dividend over a period of time

Illustration :

Sharda Ltd. has 10% cumulative preference share capital of Rs 10,00,000. The company failed to declare dividend in the year 2007. However, it wishes to pay dividends in the year 2008. Mahesh is a shareholder holding cumulative preference shares worth Rs 1,00,000. He would be entitled to receive a dividend of Rs 20,000 (Rs10,000 each for the years 2007 and 2008) since the shares held by him are cumulative preference shares.

Illustration :
Sharda Ltd. has 10% non-cumulative preference share capital of Rs 10,00,000. The company failed to declare dividend in year 2007. However, it wishes to pay dividends in the year 2008. Mahesh is a shareholder holding preference shares worth Rs 1,00,000. He would be entitled to receive only the current year's dividend of Rs 10,000 since he holds non-cumulative preference shares.

2. Redeemable and Irredeemable Preference Shares: Those preference shares which have to be repaid by the company after a specified period of time are called redeemable preference shares while those which need not be repaid in the lifetime of the company are called irredeemable preference shares. Section 80 (5A) of the Companies Act, 1956 does not permit a company to issue irredeemable preference shares or shares redeemable after the expiry of a period of 20 years from the date of issue.

Figure 4.5 Redeemable and Irredeemable Preference Shares

To redeem its preference shares a company has to follow provisions of Section 80. According to this section, the company can only redeem fully paid preference shares. The shares can be redeemed either out of divisible profits or out of the amount raised from the issue of new shares. If the company redeems the shares wholly or partly out of profits, then the company must transfer the amount equal to the face value of the shares redeemed out of profits to a special account called 'capital redemption reserve account'.

Illustration :
Moti Ltd. issued redeemable preference share capital of Rs 10,00,000 in the year 2000 to be redeemed after 7 years at par. The shares are fully paid up. In 2007, the company redeems its preference share. It is decided that the preference shares will be redeemed partly out of profits and partly from the proceeds of a fresh issue of equity shares. Thus, it issues new equity shares of Rs 6,00,000 to the public. The proceeds of this issue are used to redeem the preference shares. The balance shares (Rs 4 lakh) are to be redeemed out of profits. So, the company will have to transfer an amount of Rs 4,00,000 out of its distributable profits and free reserves to its capital redemption reserve in order to comply with the provisions of section 80. Thereafter, Moti Ltd. can redeem its preference shares.

3. Participating and Non-Participating preference shares: Participating Preference shares enable the holders to receive not only dividend but also the right to participate in further profits with or after payment of dividend to equity shareholders. A non-participating share is one which does not give such right to participate in the profits and only provides for a fixed dividend.

Illustration **:**
The share capital of Savera Ltd. consists of 10% participating preference shares (of Rs 10,00,000/-) and equity shares (of Rs 10,00,000/-). The company pays 10% dividend to its preference shareholders and 15% dividend to its equity shareholders. After payment of dividends, there is still a surplus of Rs 2,00,000 in its accounts which is to distributed equally among shareholders. Surjeet is a shareholder holding preference shares worth Rs 1,00,000/-. He would be entitled to receive an amount of Rs 20,000 (Rs10, 000/- as dividend on the preference and Rs 10,000 as share in residual profits) since the shares held by him are participating preference shares.

Illustration **:**
The share capital of savera ltd. consists of 10% non-participating preference shares (of rs 10,00,000) and equity shares (of rs 10,00,0000). the company pays 10% dividend to its preference shareholders and 15% dividend to its equity shareholders. after payment of dividends, there is still a surplus of rs 2,00,000 in its accounts which is to distributed equally among shareholders. surjeet is a shareholder holding preference shares worth rs 1,00,000. he would be entitled to receive an amount of rs 10,000 only (as dividend on the preference). he is not entitled to receive a share in residual profits since the shares held by him are non - participating preference shares.

4. Convertible and Non – Convertible preference shares: Those preference shares that can be converted into equity after some period of time are called convertible preference shares. Those which do not provide for such conversion are called non convertible preference shares.

Illustration

Data Ltd. offers 10% convertible preference share capital to the public. Each preference share can be converted into 2 equity shares after 5 years from the date of issue. Zeba purchases 100 preference shares of the company. After 5 years, she has an option of getting these shares converted into 200 equity shares of the company.

4.2. Distinction Between Share and Stock

The definition of the term 'Share' under the Companies Act, 1956 (Section 2(46)) includes 'Stock'. This definition, however, states that an express or implied distinction may be made between the two terms. A company can convert its shares into stock and vice versa by following the provisions of Table A (Articles 36-39). Stock is created from fully paid shares by passing an ordinary resolution8 in the general meeting. The Articles of Association of the company must permit this conversion. The Registrar must be notified of this change within 30 days.

Importance of Stock: Stock is the aggregate or consolidation of fully paid up shares. The stock is represented only by its monetary amount and not by the number of units. It is created because of its divisibility and transferability. While shares are indivisible and can be transferred only in whole numbers, the stock can be transferred in convenient, even fractional, values. However, the Board of Directors may fix some minimum amount for stock transfer.

The specific differences between share and stock are listed below:

TABLE1- Difference Between Shares and Stock

	Basis of Distinction	Shares	Stock
1	Nominal Value	Shares have a nominal value.	Stock does not have a nominal value.
2	Amount paid up	Shares may be fully or partly paid up.	Stock is always fully paid up.
3	Distinct Identity	Every share bears a distinctive number (except in demat form) which gives it an identity.	Stock is aggregate with no distinct numbers to give it an identity.
4	Divisibility and transferability	Shares are indivisible and can be transferred only in whole numbers	Stock is divisible and can be transferred in any convenient value.
5	Denomination	A particular class of shares must have equal denomination.	Stocks may be of unequal denomination.
6	Issue to public	Shares can be issued directly.	Stock is only created from fully paid shares.

4.3 Issue Of Shares

There are various ways by which shares can be issued. Some of the ways are discussed below:

4.3.1 Issue of Shares at a Premium:

When shares are issued at a price above the face value they are said to be issued at a premium. For example, a share having the face value of Rs 10 is issued at Rs 11. Here, Re 1 is the premium. The amount of premium so collected is to be transferred to an account called the 'Securities Premium Account'. This account is capital in nature and can only be utilized for the purposes specified by the Act under Section 78. These are listed below:

- Issue of fully paid bonus shares to members of the company.
- To write off preliminary expenses.
- To write off the expenses of issue, or commission paid, or discount allowed, on issue of shares or debentures of the company.
- To provide for the payment of premium on the redemption of any redeemable preference shares or debentures of the company.

Thus, the Securities Premium Account cannot be treated as a revenue reserve for distributing dividends. It can only be used for the above mentioned purposes and also for buying back of securities (section 77A).

When the shares are issued at a price below the face value they are said to be issued at a discount. For example, a share having the face value of Rs 10 as issued at Rs 8. A company may issue shares at a discount only when it meets the provisions specified under section 79. These conditions are:

- The shares must belong to a class of shares that have been already issued.
- The issue of the shares at a discount must be authorised by a resolution passed by the company in a general meeting. An approval for the same must also be obtained by the Central Government.
- The maximum rate of discount must also be specified in the resolution. Moreover, if the rate of discount exceeds 10%, the Central Government would not approve the same except considering special circumstances of the case.
- A minimum of one year must have passed at the date of the issue since the date on which the company was entitled to start its business.
- After the approval by the Central Government, the shares must be issued within two months or within such extended time as allowed by the Central Government.
- The prospectus should contain particulars of the discount allowed on the issue of the shares or of the amount that has not been written off. The defaulting company and every officer in default shall have to pay a fine upto Rs 500.
- Normally, when the company makes profits, it distributes part of these as dividends and retains the rest as reserves. Later, the company may utilize its reserves and surpluses to issue bonus shares to the existing shareholders without taking any consideration from them. Bonus issue increases the liquidity in the stocks. It also decreases the effective.

Figure 4.6 Issue of Bonus Shares

earnings per share and the book value per share. The issue of bonus shares leads to capitalization of profits. According to Article 96 of Table A, a company may give bonus to its shareholders by making partly paid up shares fully paid or by issuing new shares to members. Although, normally, free reserves are used for bonus issue, even share premium account and capital redemption reserve account may be utilized. The latter two however, can only be used for the issue of new fully paid bonus shares. The issue of bonus shares requires a provision for the same in the Articles of the company, a resolution of the board of directors as well as approval in a general body meeting. Further, if the company is listed on a recognized stock exchange, then the guidelines issued by SEBI in this regard must also be followed[9] .

Illustration :

The balance sheet of Kaagaz Paper Mills Ltd. shows that it has Rs 20,00,000 as equity share capital (20,000 equity shares @Rs 100 each), Rs 5,00,000 in its General Reserve Account, Rs 2,00,000 in Securities Premium Account and Rs 3,00,000 in Capital Redemption Reserve. It wishes to issue fully paid bonus shares of Rs 100 each to its existing shareholders in the ratio of 4:1. Thus, the company would issue 5000 new equity shares as bonus shares. Kaagaz Paper Mills Ltd. can issue these bonus shares in **any of the ways given below:**

- Capitalizing the whole of the General Reserve

- Utilizing the balances in the Securities Premium Account and the Capital Redemption Reserve (Rs 2,00,000 + Rs 3,00,000)
- Partly from all of them (e.g. Rs 2,00,000 from General Reserve, Rs 1,00,000 from Securities Premium Account , Rs 2,00,000 from Capital Redemption Reserve).

Illustration :

The balance sheet of Kaagaz Paper Mills Ltd. shows that it has Rs 5,00,000 as equity share capital, Rs 5,00,000 in its General Reserve Account, Rs 2,00,000 in the Securities Premium Account and Rs 3,00,000 in the Capital Redemption Reserve. The equity share capital consists of 10,000 equity shares having a face value of Rs 100 each, of which only Rs 50 is paid up. The company wishes to give bonus to its existing shareholders by making the partly paid up shares fully paid up. Kaagaz Paper Mills Ltd. can do so only by capitalizing the General Reserve. It cannot utilize the balances in the Securities Premium Account and the Capital Redemption Reserve for making the partly paid up shares fully paid up

When a company issues equity shares to its employees or directors at a lower price or in lieu of providing know-how or making available rights in the nature of intellectual property rights or any value additions, such shares are referred to as 'Sweat Equity Shares' (Section 79A).

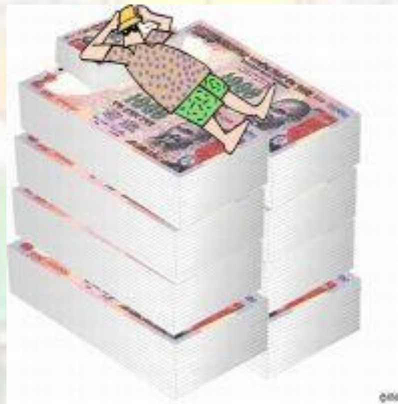


Figure 4.7 Sweet Equity

Illustration :

Harry is a director in Murthy Pharma Ltd. The company was able to acquire a patent mainly due the efforts of Harry. The patent will enable the company to earn huge profits in the future. In consideration of the services rendered by him Harry was allotted equity shares worth Rs 50,000 (without any monetary payment on his part). This is a case of allotment of sweat equity by the company.

For the issue of these shares the following conditions must be satisfied:

- The shares must belong to a class of shares that have been already issued.
- The company in its general meeting must have passed a special resolution to issue sweat equity.
- The resolution must describe the details about the issue including the number of equity shares being issued as sweat equity, their current market price, consideration to be received, if any, and the class or classes of directors or employees who are being given the sweat equity.

- On the date of the issue, a minimum of one year should have passed since the date on which the company was entitled to start its business.
- If the company is listed on a stock exchange, then it must comply with the provisions of SEBI while issuing sweat equity.

4.4 Allotment of Shares

When a company wishes to raise capital, it may do so by bringing a fresh issue of shares in the market. The people who wish to purchase the shares of the company may apply for the number of shares desired by them in an application form accompanied by some money called 'application money'. After a specified time, the company issuing shares, scrutinizes all the applications and 'allots' the shares to the eligible applicants.

Figure 4.8 Allotment of shares

What is Allotment?
The Companies Act, 1956 does not define the term "allotment". The meaning of "allotment" can be understood from some of the cases decided in India and England. One such case in the Indian context is given below.

Case Law 3

Sri Gopal Jalan and Co. vs Calcutta Stock Exchange Association Ltd.[10]

In this case, it was held that allotment is the 'appropriation of shares' to a particular person by the company. While application for shares is an offer, allotment constitutes acceptance leading to a binding contract between the company and the shareholder.

Allotment is governed by a number of general and special provisions. These are discussed below.
(A) General Provisions: As mentioned above, allotment leads to a contract between the company and shareholder. Thus, some general provisions of the Indian Contract Act, 1872 apply to allotment of shares. These are:

Figure 4.9 Allotment of Shares

- The allotment must be done by i.e. the Board of directors or as mentioned by the articles.**proper authority-**
- The allotment must be done within a **reasonable time-** or else the applicant may refuse to accept the offer.
- The allotment must be **communicated-** A mere resolution is not enough, the decision to allot shares must be communicated to the shareholder.
- The allotment must be **absolute and unconditional-** If the shareholder had mentioned any conditions in the application, the allotment is valid only if the conditions are met and not otherwise.
- If the above provisions are not met, the allotment is null and void.

(B) Special Provisions: As per the Companies Act, 1956 there are certain conditions that must be satisfied for allotment of shares by a public company [11] . These provisions differ depending on whether the issue is made to the public or not and also whether the company is allotting the shares for the first time. These are discussed from the following page:

(C) Special Provisions: As per the Companies Act, 1956 there are certain conditions that must be satisfied for allotment of shares by a public company [11] . These provisions differ depending on whether the issue is made to the public or not and also whether the company is allotting the shares for the first time. These are discussed from the following page:

A company may decide to raise capital through private placement of shares, i.e. the company may engage intermediaries like brokers to find investors. According to Section 70 of the Companies Act, 1956, a company which does not offer shares to the public for subscription can allot shares or debentures only if it submits a duly signed statement in lieu of a prospectus to the Registrar at least three days before the first allotment of securities. This statement should contain the particulars mentioned in Schedule III. If a company does not comply with these provisions then the company and every director in default can be fined upto Rs 10,000.

Illustration :

Ajanta Ltd. wishes to raise capital by placing its shares privately through brokers and underwriters. The company allots shares without submitting a duly signed statement in lieu of prospectus to the Registrar three days before the first allotment of securities. The company and every director in default had to pay a fine of Rs 10,000.

When a public company offers its shares to public at large, it has to comply with some special provisions. The rules differ in case of ‘first’ and ‘subsequent’ allotment of shares.

Share Capital

(A) First Allotment of Shares – Initial allotment of shares can be done only if the company follows the following rules:

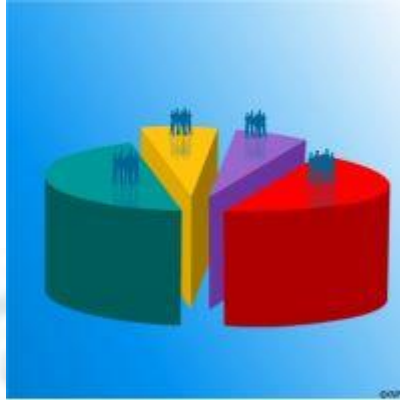


Figure 4.10 Allotment when public offer is made

- Registers its Prospectus - (Section 60(1)) – The company has to file a copy of the prospectus duly signed by the directors with the registrar on or before the date when the prospectus is made available to public.
- Receives The Minimum Subscription – (Section 69) – A public company can allot shares only if it receives the 'Minimum Subscription' for its shares along with the application money. The amount of minimum subscription is stated in the prospectus and cannot be less than 90% of the issue. If the company fails to receive the minimum subscription within 120 days of issue of the prospectus, then it will have to repay the money received from applicants for shares within the next 10 days. If the company fails to do so, the directors of the company will be jointly and severally liable to repay that money with interest (@ 6%p.a.) after the said time limit. However, these provisions should be read in combination with SEBI guidelines [12].
- Receives Application Money (Section 69) – According to Section 69(3), the amount of application money cannot be less than 5% of the face value of the share.
- Deposits the amount received in a Separate Account – According to Section 69(4), the amount of application money received has to be deposited in a separate account in a scheduled bank till the company receives a certificate of commencement or till it raises the minimum subscription for the issue.

- Follows the rules regarding the Subscription List (Section 72) – A company can only start allotting shares from the fifth day after the issue of prospectus (or at a later time as prescribed in the prospectus). This time is known as the 'opening of the subscription list'. According to Section 74, while counting the fifth day, any day which is a public holiday under the Negotiable Instruments Act, 1881, is not to be included. Although a default in following the provisions of section 72 does not invalidate allotment but such a failure imposes on the company and every defaulting officer a fine extending upto Rs 50,000. The Companies Act, 1956 does not specify the number of days for which the subscription list is to be kept open. But as per the norms of the stock exchanges, the list must remain open for a minimum of 3 days and should be closed within 10 days.
- Gets Shares listed on a Stock Exchange (Section 73) - The company must apply to one or more recognised stock exchanges for listing its shares. The name of the stock exchange(s) where such permission is sought must be given in the prospectus. If the company fails to get the shares listed before the expiry of ten weeks from the date of the closing of the subscription lists the allotment is void. In such a case, the company has to refund without interest all money received from applicants within 8 days. If it fails to do so, the company and every

defaulting director will be jointly and severally liable to pay back the money with interest at such rate as may be prescribed [13] .

(B) Subsequent Allotment of Shares- In case of subsequent allotment of shares, most of the above provisions apply. Thus, the company has to –

- Register its Prospectus - (Section 60(1))
- Receive Application Money (Section 69)
- Follow rules regarding the Subscription List (Section 72)
- Get the Shares listed on a Stock Exchange (Section 73)

It is, however, not required to ensure a minimum subscription and to deposit the money in a separate bank account.

In case of allotment of debentures, the company is required to follow the following special provisions as explained above –

- Register its Prospectus - (Section 60(1))
- Follow rules regarding the Subscription List (Section 72)
- Get the Debentures listed on a Stock Exchange (Section 73)

Figure 4.11 Debentures

Unlike shares, the first or subsequent allotment of debentures does not require the company to ensure a minimum subscription or to raise a minimum amount of application money or to deposit the money in a separate bank account.

According to Section 71 of the Companies Act, 1956, an allotment is said to be irregular if it is done without following the provisions of section 69 or 70. The table below indicates the circumstances when allotment is considered irregular:

TABLE 2 – Type of Issue and Conditions when it becomes Irregular

	Company and Allotment	Conditions for irregular allotment	Section violated
1	Public company not offering shares to the public.	Allots shares ***without*** submitting a statement in lieu of the prospectus to the Registrar at least three days before the first allotment of securities.	Section 70
2	Public company offering shares to the public-First Allotment	Allots shares ***without*** receiving the minimum subscription within 120 days of issue of the prospectus.	Section 69(1)
		Allots shares ***without*** receiving application money at a minimum rate of 5% of the face value of the share.	Section 69(3)
		Allots shares ***without*** depositing the application money received in a separate account in a scheduled bank	Section 69(4)
3	Public company offering shares to the public-Subsequent Allotment	Allots shares ***without*** receiving application money at a minimum rate of 5% of the face value of the share.	Section 69(3)
4	Private company	No conditions prescribed by Section 69 - 70. Therefore, a private company can never do irregular allotment.	

Effects of Irregular Allotment:

As per Section 71, an irregular allotment has the following implications:

- The allotment will be voidable at the option of the applicant within 2 months after the holding of the statutory meeting of the company. Where the law does not require the company to have a statutory meeting or where the meeting has already been held the allotment is voidable within two months after the date of the allotment. **Allotment Voidable -**

Illustration :

Rose Marbles Ltd. is a public company which is offering shares to the public for the first time. It offers 10,000 equity shares of Rs100 each to the public. The issue is fully subscribed and the company receives application money of Rs 4,00,000 along with the applications. Chandan, a director in the company, asks the accountant to keep the money receives with the applications in his office vault. After the stipulated time, the company starts allotting the shares. Somdatt had applied for 500 shares of the company. He receives a letter of allotment. However, the offer is voidable at his option. He may reject the allotment of shares as the allotment is irregular (the money was not deposited in a scheduled bank – Section 69(4)).

Responsibility of the Directors – The defaulting directors who are knowingly or wilfully a party to the violation of the provisions of section 69 or 70 are liable to compensate the company and the allottee for any loss, damages or costs which the company or the allottee may have incurred because of the irregular allotment. However, the suffering

party must take the necessary action within 2 years from the date of the allotment. Further, if the company defaults in provisions of Section 69(4), i.e. it allots shares without depositing the application money received in a separate account in a scheduled bank, then the responsible directors may have to pay a fine upto Rs 50,000. Similarly, a violation of Section 70(4), i.e. allotment without submitting a statement in lieu of the prospectus to the Registrar at least three days before the first allotment of securities imposes a penalty of Rs 10,000.

Illustration :

In the previous illustration, where the application money was not deposited in a scheduled bank, Chandan, the director of the company, who was responsible for violation of section 69(4) will have to pay a fine of Rs 50,000.

As per Section 75, every company (private or public) with a share capital has to file with the Registrar a return as to allotment when it makes any allotment of its shares. The return has to be filed within a period of 30 days. The company has to inform the registrar about -

- The number and nominal amount of the shares allotted.
- The names, addresses and occupations of the allottees.
- The amount paid or due on each share.

Figure 4.12 Filing Return as to allotment within 30 days

- The copy and details of the contract through which shares were allotted otherwise than for cash (except in the case of shares allotted as bonus shares).
- In the case of bonus shares, apart from giving information about the first three particulars, the company also has to file a copy of the resolution authorising the bonus issue.

In case of default, every officer in default is punishable with a fine extending upto Rs 5,000 for every day during which the default continues. Also, an omission of the first three particulars attracts a penalty of upto Rs 50,000 from the guilty officers and promoters of the company.

4.5 Forfeiture of Shares

When a company issues shares, normally the shareholders are not required to pay the amount at once. Some part of the money is paid to the company initially on application of shares, another part on being allotted the shares and the remaining amount in one or more instalments called as 'calls'. The com pany makes these calls as and when it requires capital. If a shareholder fails to pay the called up capital then his / her shares may be taken back from him / her by the company as a penalty.

Figure 4.13 Forfeiture of Shares

This is called as 'forfeiture of shares'. Although forfeiture usually occurs due to non payment of calls, it can also be made for any other reason specified in the company's articles. A company can forfeit shares according to the provisions given in its articles. If the articles do not contain such provisions, then regulations 29-35 of Table A of the Companies Act,1956 apply. The provisions regarding calls and forfeiture are discussed in the following sub-sections.

As explained above, the company may call up the unpaid amount from the shareholders from time to time. The board is required to pass a resolution for making a call. The articles of the company have provisions regarding calls. If nothing is mentioned in the articles, then the provisions laid down in Articles 13-18 of Table A are applicable while making calls. These are listed below:

- The amount called must not be more than one-fourth of the face value.
- The dates of two consecutive calls must differ by at least a month.
- A minimum of 14 days' notice must be given to the members.
- The notice must mention the time, place of payment and the amount called.

If a person fails to make call payment by the due date, then he / she may be liable to pay interest thereon. Further, the Board may also accept all or part of the money uncalled and unpaid upon the shares from a member. This is called **calls in advance.**

Illustration :

The shares of a company have a face value of Rs 100. Out of this, the shareholders have to pay Rs 25 on application and Rs 35 more on allotment. Further, the board of directors passes a resolution to make the first call of Rs 20, which is duly received by the company. Thus, on this share, a sum of Rs 80 has been called and paid up. However, a

sum of Rs 20 still remains uncalled on the share. The company may call up this amount any time in the future.

On making a call if a member defaults in making payment by the due date, then the Board may send him / her a notice informing him / her that the payment must be made by a later date or else the shares will be forfeited. This new date cannot be earlier than the expiry of 14 days from the date of service of the notice. If the defaulter fails to make the payment even at such date, then the board will pass a resolution to forfeit the shares. The forfeited shares are usually reissued by the company. A valid forfeiture will have the following implications:

Figure 4.14 Notice for Forfeiture

- The defaulter ceases to be a member of the company.
- The defaulter continues to be liable for all amounts which, at the date of forfeiture, were payable by him / her to the company in respect of the shares.
- The defaulter is not entitled to a refund of the amount paid up by him / her in respect of the forfeited shares.

A valid forfeiture must be in accordance with the articles (or Table A) and must be made bona fide for the benefit of the company.

Illustration :

Mayur Ltd. has issued 10,000 equity shares of face value Rs 100 each to the public. The company duly receives Rs 10 per share on application, Rs 20 per share on allotment and Rs 30 per share on making the first call from Ketan who has been alloted 300 shares in the company. However, when the company makes the final call of Rs 40 per share, Ketan failed to pay the amount within the stipulated time and the company forfeits his shares. Thus Ketan ceases to be a member of the company and will not be refunded the money paid by him (Rs 60) in respect of the forfeited shares.

Once the shares are forfeited, they may be either cancelled or reissued to some other person. The person who purchases the forfeited shares becomes a member of the company. His / her title is not affected by any irregularity in the proceedings with reference to the forfeiture, sale or disposal of the share. While reissuing the forfeited shares the company should fix the price of reissue such that the total amount received in respect of the shares (i.e. price of the reissued of shares + amount paid by the previous owner

Figure 4.15 Reissuing forfeited Shares

in respect of the shares) is not below its face value. This is done to ensure that reissue does not amount to issue at a discount or the provisions of section 79 would become applicable.

Illustration :

In the previous Illustration, Mayur Ltd. reissues the forfeited shares to Pragya. The minimum price at which the shares can be issued to her as fully paid are Rs 40 since the amount of discount cannot be more than the amount forfeited (Rs 60) by Ketan. If the company issues the shares to Pragya for a price less than Rs 40, say for Rs 30 then the total amount recovered in respect of each share will be Rs 90 (Rs 60 received from Ketan + Rs 30 received from Pragya). But the face value of the share is Rs 100, so selling the share to Pragya for a price below Rs 40 amounts to issue of shares at a discount.

In case the previous shareholder (whose shares had been forfeited) requests the company to cancel the forfeiture, the board can nullify the forfeiture if it thinks that this is in the interest of the company. However, annulment of forfeiture can be done only if the forfeited shares have not been cancelled or reissued to someone else. The directors must pass a resolution to cancel forfeiture and the previous shareholder has to pay all the calls due with interest.

Illustration :

Continuing with the previous illustration, after the shares are reissued to Pragya, Ketan applies to the company to cancel the forfeiture and reissue the shares back to him. He pleads that he has resolved his financial problems and can now pay the call on shares along with any interest due on the calls. The company cannot accept his application now because the forfeited shares have been reissued to Pragya.

A lien is defined as "A legal instrument giving a person, business, etc. the legal right to take, hold or sell another person's property for debt or restitution of some sort." - http://wiki.answers.com/Q/What_is_a_lien (Date: 21-02-2010, 13:01) If the articles of a company so provide or if the company adopts Table A of the Companies Act, 1956 , then it can have lien on partly paid shares for the uncalled amount as well as all debts payable by the shareholder (Article 9, table A). Thus, a company can sell shares held by a person for unpaid debts by giving him/ her 14 days notice (Article10, table A).

Lien appears similar to forfeiture because in both cases the company can take the shares back from the member. However, the two acts differ in a number of ways:

Table 3: Differences between Forfeiture and Lien

Basis	Forfeiture	Lien
Purpose	Forfeiture is done in case of non-payment of any sum which, by the terms of issue of a share, is due from the shareholder (*article 35*).	A company can have lien on partly paid shares for uncalled amount as well as all debts payable by the shareholder (*Article9, table A*).
Reduction in Capital	Forfeiture may or may not result in reduction of capital.	Lien does not result in reduction of capital.
Disposal	Forfeited shares may be reissued or cancelled.	Shares acquired through lien can only be sold.
Nature	Forfeiture is penal in nature.	Lien is meant as a security in transaction.
Example	Simon, a shareholder of Rahat Ltd., owes Rs 10,000 to the company in respect of unpaid calls on shares held by him. The company can resolve to forfeit his shares.	Simon, a shareholder of Rahat Ltd., owes Rs 10,000 to the company in respect of goods purchased by him from the company on credit. The company can exercise lien over his shares.

Surrender refers to an intentional and voluntary giving up of shares by the shareholder to the company. The Companies Act, 1956 does not have provisions regarding surrender of shares. However, if the articles of the company allow a shareholder to surrender the shares, then the company can accept such surrender but only in case where forfeiture is unavoidable. Thus, where otherwise the shares are bound to be forfeited by the company, surrender may be allowed to reduce procedural difficulties. Usually, partly paid

Figure 4.16 Surrender of Shares

shares are surrendered by members who fail to pay the amount due on calls or otherwise in respect of the shares. But even fully paid shares may be surrendered if they are to be exchanged for new shares having the same face value.

Illustration :

Tarmeen holds 100 shares in Amrit Motors Ltd. When the company makes its last call on shares, Tarmeen is not in a position to pay the money due on the shares. Stating this fact she applies to the company to allow her to surrender her shares. The articles of the company allow it to accept the surrender of shares. Thus, Amrit Motors Ltd. can accept Tarmeen’s request for surrender of shares

4.6 Transfer / Transmission of Shares

4.6.1 Transfer of Shares

A shareholder can sell his / her shares to others. This transfer of shares is free in case of public companies although the shareholders of the company may be restrained from doing so by the articles of the company (especially in case of private companies). In any case, the shares can only be transferred by following the provisions for transfer of shares as given under sections 108 to 112 of the Companies Act, 1956. Either the transferor or the transferee can apply for the registration of the transfer of shares. If the request is made by

Figure 4.17 Transfer of Shares

the transferor in respect of partly paid shares, the transfer will be registered only if the company gives notice of the application to the transferee and the transferee makes no objection to the transfer within a period of two weeks (Section 110).

Procedure for Transfer

The procedure for transfer of shares given under section 108 of the Companies Act, 1956 is as follows:

(1) Stamping of Form: The share transfer form shall be presented to the prescribed authority. The authorized Government official would stamp the form with date. Thereafter, the parties concerned (transferor and transferee) will fill and sign the form.

(2) Proper Instrument: A transfer will only be registered by the company if it receives a written request for transfer along with the share or debenture certificate and a proper instrument of transfer. This means that the instrument must be duly stamped and should contain the name, address and occupation of the transferee

(3) Stipulated Time for Delivery of the form: The form, completed in all respects, must reach the company by a stipulated time. Where the shares are listed on a recognised stock exchange, the form must be delivered before the date on which the register of members is first closed or within twelve months from the date of such presentation, whichever is later. Where the shares are not listed on a recognised stock exchange, the stipulated time is within two months from the date of presentation.

The above provisions do not apply to transfer of security if the transferor and the transferee have a demat account [14] with a depository [15].

Refusal of registration by company and appeal against refusal

The articles of a company may empower it to refuse registration of the transfer in certain circumstances. A private company has to mention the restriction on transferability (pre-emption clause) in its articles. The directors may refuse registration of transfer if provisions of section 108 of Companies Act, 1956 have not been followed. The directors may also refuse to register transfer if it is prejudicial to the interest of the company (Bajaj Auto Ltd. vs. N. K. Firodia & ANR, 1971 [16]). A listed public company can only refuse to register transfer if it has sufficient reason to do so. In such a case, the company must notify the transferee and the transferor of this decision and the grounds of refusal within two months (Section 111). When an application is made by a depository, company, participant or investor, the Tribunal checks if the transfer contradicts provisions of the SEBI Act, 1992, or any other law (Section 111A). An appeal can be made within two months of the receipt of the notice. The Tribunal considers the appeal, and may dismiss it or order the company or depository to register the transfer. If the orders of the Tribunal are not followed the company and every officer in default may be fined upto Rs 10,000 with an additional fine of Rs 1,000 for each day the default continues.

Illustration :

Haider submits an unstamped share transfer form to Balram Ltd for transfer of shares in his name. The directors refuse to register the transfer. Their decision is justified because the instrument is not in proper form (violation of section108).

Blank Transfer

A shareholder may transfer shares without filling in the name of the transferee on the instrument. This type of transfer is call ed a blank transfer. Blank transfers are done when the transferee does not want to keep the shares for long but intends to sell his shares immediately to some other party. The shares are passed on from one person to the next. Eventually, when the shares are purchased by someone who wants to retain them, this person fills the transfer form by inserting his name in the blank and presents the

Figure 4.18 Blank transfer

shares for registration after paying stamp duty. Section 108 lays a condition that transfer of shares must be done within a stipulated time (as mentioned above in 'Procedure of transfer (3)'). This helps in controlling the misuse of blank transfers.

Illustration :
Daya has 100 shares of Vrinda Ltd. She sells these shares to Firoz. Firoz asks her to fill in all the particulars in the transfer deed except the name of the transferee. Daya complies with his request and gives him the share certificate along with the transfer deed in which the name of the transferee is not mentioned. This is a blank transfer. Later Firoz sells the shares to Lily. Lily enters her name as transferee in the transfer form and submits the shares for registration.

Forged Transfer

If the signature of the transferor is forged by someone on the transfer deed, such a transfer is called forged transfer. If a person gets the shares transferred in his name on the basis of a forged transfer and sells it to someone else, the buyer will still not be a shareholder and the original shareholder can nullify the transfer. The innocent buyer, however, may sue the company for damages. A forged transfer is not valid even if the transferee gets the shares registered in his name. It does not transfer ownership to the transferee.

Illustration :

Kriti is a shareholder in Vinay Chemicals Ltd. Her neighbour Sunita forges Kriti's signature on a transfer deed and applies for transfer of shares in her name. The company registers the transfer and issues a share certificate to Sunita. Sunita then proceeds to sell the shares to Jaspal who does not know of the forgery. In this case, Jaspal still has no right on the shares. Kriti on discovering the forgery can ask the company and get her shares back. The company will compensate Jaspal for his loss by paying the current market price of the shares to him. In turn, it will sue Sunita to recover the amount of loss sustained by it.

Transmission is the process by which shares of a deceased, lunatic, bankrupt or insolvent person are transferred in the name of surviving joint holders or a nominee or legal heir. Transmission is different from transfer of shares because it happens due to the operation of law. Thus, transmission does not require a duly stamped and executed transfer deed; it merely requires that the necessary proof of circumstances leading to transmission be delivered to the company to make it effective. On registration of the transmission, the nominee or heir becomes the shareholder of the company [17].

Nowadays, like transfers, transmission is also done electronically

Illustration :
Atmaram had 150 shares in Sandhya ltd. He died of a heart attack. Prakash is his only child. Prakash will apply to the company attaching a copy of Atmaram's death certificate to transmit the shares in his name. The shares will then be transmitted to Prakash.

he regulations for transfer and transmission of debentures are similar to those in case of shares (Section 108, 109B, 111). However, unlike shares, the time period restriction does not apply to debenture transfer deeds. The rules regarding stamp duty are also different from share transfer. While in case of shares, the stamp duty is to be paid on the basis of money paid in the transaction, in case of debentures it is calculated as a percentage of the nominal value of the debentures.

Illustration :

Sudhir Ltd. is an unlisted company. Anupama purchases its shares and debentures from someone and wishes to get them transferred in her name. She must apply for the transfer of shares within two months from the date of presentation of the form to the prescribed authority (Section 108). She can apply for the transfer of dentures even after two months from the date of presentation of the form to the prescribed authority.

4.7 Dividend

Defining Dividend

"Dividends are payments made by a corporation to its shareholder members." http://en.wikipedia.org/wiki/Dividend (Date: 21-02-2010, 13:10)

Dividend is "A distribution of a portion of a company's earnings, decided by the board of directors, to a class of its shareholders. The dividend is most often quoted in terms of the dollar amount each share receives (dividends per share). It can also be quoted in terms of a percent of the current market price, referred to as dividend yield."

Figure 4.19 Dividends

http://www.investopedia.com/terms/d/dividend.asp (Date: 21-02-2010, 13:10)

As seen above, dividend is that part of the profits of the company which is distributed to shareholders. Dividends may be declared by the company during or at the end of the year by passing a resolution. The Board of Directors proposes a rate of dividend which may be approved by the shareholders. The shareholders in their meeting cannot increase the rate of dividend although they can resolve to distribute the dividend at a lower rate. The legal provisions for the same are discussed in the following section.

1. Sources of Dividend: A company can pay dividend only out of current or past profits (after depreciation) or out of the moneys provided by the Central or State Government (Section 205). The Central Government may, (in public interest) waive off the requirement of providing for depreciation. Further, if the company has incurred losses in the past, then the loss or depreciation for that year, whichever is less, can be set off against the profits (past or current) before dividend is paid.

Figure 4.20 Paying Dividends

Illustration :
Lata ltd had a profit of Rs 2,50,000 in 2008 and a loss of Rs 50,000 in 2007. In both years the depreciation to be charged is Rs 10,000. The company wishes to pay dividend to its shareholders. The amount of profit available for dividends is current profit less current year's depreciation and previous year's loss or depreciation, whichever is less, i.e. Rs 2,50,000 – Rs 10,000 – Rs 10,000(lower of Rs 50,000 and Rs 10,000). Thus, the amount of profit available for dividends is Rs 2,30,000.

2. Transfer of Dividend: On declaration of final or interim dividend, the amount should be deposited in a separate bank account within five days.

3. Transfer to Reserve: The company also has to transfer certain profits to reserves. The amount is to be transferred to reserves in accordance with the rules of the Central Government.

4. Mode of Payment: Dividends are to be paid in cash.

5. Payment only to shareholders: Dividend is paid to the registered shareholder, to his / her order or his / her banker, or to the bearer of share warrant.

6. Payment within stipulated time: The dividend has to be paid within 30 days from the date of declaration. If the company fails to do so, every director of the company who is knowingly a party to the default, can be imprisoned for up to three years and will have to pay a fine of Rs 1,000 for every day the default continues. The company will have to pay interest at the rate of 18% p.a. (Section 207). The penalties do not apply where the dividend could not be paid because of the operation of any law or because the shareholder's express directions could not possibly be followed or in case of disputed dividends. Further, the company may adjust the dividends against any unpaid sum due from the shareholder.

Illustration :
In respect of 200 shares of Parmeet ltd, there is a dispute relating to the ownership of shares due to a forged transfer. The decision on this case is pending in the court. Parmeet ltd declared dividends on its shares. It pays all the dividends within the stipulated time except the one which was due on the disputed shares. The company is not liable for any penalty imposed under section 207.

As per Section 205A, any dividend which remains unpaid or unclaimed after 30 days of declaration of dividend is to be transferred to the 'Unpaid Dividend Account' in the next 7 days. If the company fails to transfer the amount within 7 days, it would have to pay

interest @ 12% p.a. on the unpaid amount. If the money in the 'unpaid dividend account' remains unpaid or unclaimed even after 7 years, it shall be transferred to the 'Investor Education and Protection Fund' set up by the Central Government (Section 205C). If the

Figure 4.21 Unclaimed Dividends

company fails in following the provisions of Section 205A, then the company and the defaulting officers may have to pay a fine of upto Rs 5,000 for each day the default continues.

Interim dividend is the dividend "which is declared and distributed before the company's annual earnings have been calculated [18] "

http://www.investorwords.com

Section 2 (14A) of the Companies Act, 1956 includes interim dividend as dividend. Therefore, the provisions of Section 205-207 apply to interim dividend as well. Thus, while earlier the decision to pay interim dividend was revocable, now such a declaration is binding and interim dividends constitute an enforceable debt on the company. The board must take the decision to pay interim dividend after carefully analyzing its financial status, profits and liquidity.

A company may issues shares for raising funds for the construction of buildings or plants. Sometimes these projects cannot be made profitable in the near future. In such cases, Section 208 provides that due to the absence of profits, interest can be paid on shares capital. This interest can be charged to capital as cost of construction. However, this interest can be paid only with the prior approval of the Central Government. Further, the provision for the same should be either given in the articles.

Share Capital

Figure 4.22 Issuing Shares for raising funds

or taken through a special resolution to permit the payment of interest out of capital. The maximum rate of interest can be 4% p.a. (or as approved by Central Government).

Section

SECTION	DESCRIPTION
2(46)	Definition of Share
69	Prohibition of Allotment without Minimum Subscription
70	Allotment and Statement in Lieu of Prospectus
71	Effects of Irregular Allotment
75	Return as to Allotment
78	Issue of Shares at a Premium
79	Issue of Shares at a Discount
79A	Issue of Sweat Equity
86	Types of Shares
108-112	Transfer and Transmission of shares
205-207	Provisions about Dividends
208	Payment of Interest out of Capital

Share Capital

Summary

Different Type of shares

- **Equity share capital**
  - With voting rights; or
  - With differential rights
- **Preference share capital**
  - Cumulative and Non-Cumulative Preference Shares
  - Redeemable and Irredeemable Preference Shares
  - Participating and Non-Participating Preference Shares
  - Convertible and Non – Convertible Preference Shares

Issue of shares

At Premium: Issue at a price above the face value
At Discount: Issue at a price below the face value
Bonus Shares: Utilize the company's reserves and surpluses to issue shares to existing shareholders without taking any consideration from them. Bonus shares can be issued by:
(i) Making partly paid up shares fully paid.
(ii) Issuing new shares.
Sweat Equity Shares: Issue of shares to employees or directors at a lower price or in lieu of providing know-how or making available rights in the nature of intellectual property rights or any value additions.

General Provisions : Allotment to be

- Made By Proper authority
- Done Within a Reasonable time
- Communicated
- Absolute and unconditional

(A) Allotment when no public offer is made: The company should submit a statement in lieu of prospectus to the Registrar at least three days before the first allotment of securities.
(B)Allotment when public offer is made
First Allotment of Shares

- Register its Prospectus.
- Receive Minimum Subscription.
- Receive Application Money.
- Deposit the amount received in a Separate Account.
- Follow rules regarding Subscription List.
- Get Shares listed on a Stock Exchange.

Subsequent Allotment of Shares

- Register its Prospectus.
- Receive Application Money.
- Follow rules regarding Subscription List.

- Get the Shares listed on a Stock Exchange.

Forfeiture of shares

- If a shareholder fails to pay the called up capital then his / her shares may be taken back from him / her by the company as a penalty. This is called as 'forfeiture of shares'.
- Once the shares are forfeited, they may be either cancelled or reissued to some other person.

Procedure for Transfer

- **Stamping of Form**
- **Proper Instrument :**
  - Duly stamped
  - Contains the name, address and occupation of the transferee.
- **Stipulated Time for Delivery of the form:**
  - Where the shares are listed on a recognised stock exchange, the form must be delivered before the date on which the register of members is first closed or within twelve months from the date of such presentation, whichever is later.
  - Where the shares are not listed on a recognised stock exchange, the stipulated time is within two months from the date of presentation.

Blank Transfer

Blank Transfer is the transfer of shares without filling in the name of the transferee on the instrument.

Forged Transfer;

If the signature of the transferor is forged by someone on the transfer deed, such a transfer is called a forged transfer.

Transmission of Shares

The process by which shares of a deceased, lunatic, bankrupt or insolvent person are transferred in the name of surviving joint holders or a nominee or legal heir.

Dividend

That part of the profits of the company which is distributed to shareholders.;

Legal Provisions Related to Dividend

- **Sources of Dividend:**
  - Current profits o Past profits
  - Money provided by the Central or State Government.
- Amount of dividend to be deposited in a **separate bank account** within 5 days.
- **Transfer** of certain profits **to reserves** before payment of dividend
- Dividend to be **paid in cash**
- Payment only **to shareholders**
- **Payment within stipulated time:** The dividend has to be paid within 30 days