

*De Jure*

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## Reduction of Share Capital – A Comparative Analysis



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## Introduction

The Reduction of share capital is generally done for increasing the shareholder's value and in events such as accumulated losses, reduction in value of assets and the company becoming over capitalised. When a company makes continuous losses, the financial position of the company may not indicate the correct position of the company. Basically, the Reduction of Share Capital is carried out with a view to have an efficient capital structure of the company.



The Ministry of Corporate Affairs ("**MCA**") had notified the new Companies Act, 2013 (the "**New Act**") in August 2013 with a view to repeal and replace the Companies Act, 1956 ("**Old Act**"). However, at that time only certain provisions of the New Act had been made operational. Since then, the MCA has been gradually notifying the provisions of the New Act from time to time.

The MCA through its recent Notification dated December 07, 2016 has notified certain more provisions of the New Act which, *inter alia*, includes the provisions with respect to Reduction of Share Capital, variation of shareholders rights, provisions related to Schemes of Amalgamation/ Demergers (except provisions in relation to merger/amalgamation with a foreign company and certain other provisions) and Winding-Up. The said newly notified provisions will come to force with effect from December 15, 2016 thereby repealing the corresponding provisions under the Old Act. The MCA has also notified, vide its notification dated December 15, 2016, the NCLT (Procedure for Reduction of Share capital of Company) Rules, 2016 (the "**New Rules**"). These New Rules are yet to be published in the Official Gazette and will come in to force on the date of such publication.

This Note intends to provide a comparative analysis pertaining to the provisions of 'Capital Reduction' under the Old Act vis-à-vis the New Act.

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Under the Old Act, Sections 100 to 105 dealt with the subject of Capital Reduction, whereas Section 66 of the New Act deals with the same.

## Comparative Analysis

The provision under the New Act has included various conditions and restrictions which were not present in the provisions relating to the reduction of share capital under the Old Act and therefore, the process has somewhat been made more strict in terms of timelines, procedural requirements and punishments for non-compliance.

For ease of reference, we have set out herein below the comparison of different conditions and restrictions of the New Act vis-à-vis the Old Act with respect to 'Capital Reduction':

No.	Provision	New Act	Old Act	Remarks/ Impact
1.	<b>Forum</b>	Application to the National Company Law Tribunal (the " <b>NCLT</b> ").	Application to the High Court.	<i>Only change in forum from High Court to NCLT.</i>
2.	<b>Condition for applying for Reduction</b>	The company must not be in arrears in repayment (including payment of interest) of any of its deposits that are accepted by it either before or after the commencement of the New Act.	No such provision under the Old Act.	<i>A new restriction on the company (bit harsh condition though).</i>
3.	<b>Notice to creditors</b>	In all cases of reduction of share capital	Only where the reduction of share capital involves either: (i) diminution of liability in respect of unpaid share capital; or (ii) payment to any shareholder of any paid-up share capital; or	<i>Additional responsibility on the companies. Greater administering power to NCLT.</i>

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No.	Provision	New Act	Old Act	Remarks/ Impact
			(iii) in any other case, if directed by the High Court.	
4.	<b>Notice of Reduction</b>	<p>NCLT to give notice of the reduction application to:</p> <ul style="list-style-type: none"> <li>(i) Central Government;</li> <li>(ii) ROC;</li> <li>(iii) SEBI (<i>if the company is listed</i>);</li> <li>(iv) creditors of the company,</li> </ul> <p>to take into consideration any objections made by any of the above within a period of three (3) months from the date of receipt of the notice of such objection.</p> <p>If no representation is received by any of the above persons, within the said period, then it shall be presumed that none of the above persons have any objection for Capital Reduction.</p>	Only the creditors were entitled to object to the reduction.	<p><i>Additional Parties have the right to object the scheme of capital reduction.</i></p> <p><i>It can be argued that the time period of three months is a bit long. However, the good thing is that deemed consent of the said additional persons after the expiry of the said period should help in disposal of cases in a time bound manner.</i></p>
5.	<b>Compliance with Accounting Standards</b>	The accounting treatment, proposed by the company for such reduction, must be in conformity with the accounting standards specified in Section 133 or any other provision of the New Act along with an auditor's	No such provision.	<i>An additional requirement, which seems reasonable.</i>

No.	Provision	New Act	Old Act	Remarks/ Impact
		certificate to this effect.		
6.	<b>Publication of the order</b>	Failure to publish the order of the NCLT confirming the Capital Reduction is punishable with a fine.	No penalty for non-publication of the order.	<i>A new and strict penal provision.</i>
7.	<b>Filing of copy of order with ROC</b>	The company is to file with the ROC a certified copy of the order of the NCLT within thirty (30) days of the receipt of the copy of the order.	No timeline was provided.	<i>A new timeline compliance.</i>
8.	<b>Punishment for concealment</b>	Stringent punishment and penalty under section 447 (Fraud) is provided for any officer of the company responsible for the act of concealment of the name of any creditor entitled to object to the capital reduction.	The earlier provision contained a punishment of imprisonment for a term which may extend to one (1) year or with fine or both.	<i>Penalty for concealment of name of creditors is a welcome move especially from the perspective of good corporate governance.</i>

Provisions, which were present under the Old Act but not present under the New Act, are summarized below:

1. The provision for fixing of a date for the ascertainment of debts and claims of creditors by the High Court has been removed;
2. The power of the High Court under the Old Act for the dispensation with the requirement of sending notices to the creditors has been removed; though, the New Rules have granted such power to the NCLT and has, additionally, also provided NCLT the power to dispense with the publication of notice of reduction in newspapers;
3. The power of the High Court for addition of the words "and reduced" to the name of the company, during the commencement of the process of reduction or at any time after the date of the order for such reduction, has been removed.

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## Our Views

The New Act has made the obtaining of the consent of the creditors mandatory for every form of reduction of share capital including when the reduction is required for cancellation of paid-up share capital which is lost or is unrepresented by the company by available assets, thereby widening the scope of power of the NCLT in administering the reduction of share capital of companies. The provisions of the New Act and the rules made therein provide a crisp and clear procedure for the reduction of share capital of companies. Though there are strict timelines mentioned under the New Act, certain provisions, especially the provision wherein the NCLT is required to send notices to the Central Government, the ROC, SEBI and the creditors of the company may turn out to be a lengthy process in practice. It is also important to consider the inclusion of harsh penal provisions and the increase in the quantum of penalty. Since the provisions for Capital Reduction and the New Rules made therein have been just notified, it would be interesting to see how the new regime, under NCLT as compared to the High Court earlier, turns out to be especially in light of the (current) inadequate infrastructure of the NCLT and considering substantial amount of cases that NCLT will be required to handle under Insolvency and Bankruptcy Code, 2016 in addition to various other cases under the New Act.



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