Corporate Accounting

Reduction of Share Capital

Reduction of share capital is unlawful except when sanctioned by the court because conservation of capital is one of the main principles of company law. The issued share capital of a company represents the security in which creditors rely

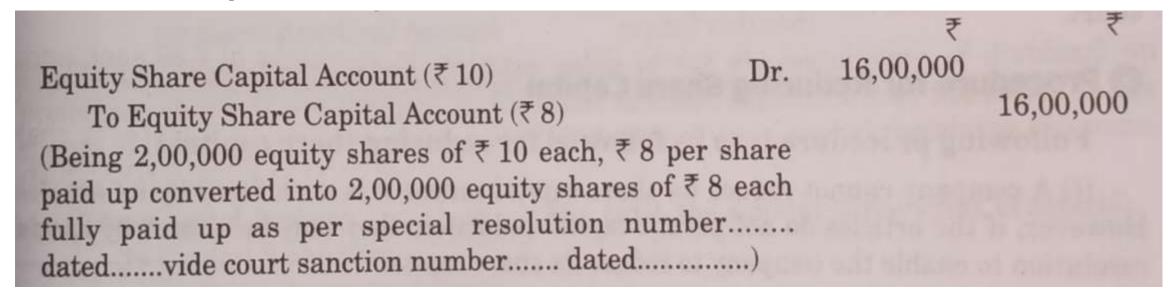
Companies usually do not call the full value of shares at one time. The uncalled capital act as a future security for the company's creditors. Therefore, any reduction of capital reduces the security of the creditors. Keeping this in view, all the safeguards have been provided for in the companies act to conserve the capital of the company. However, in genuine cases, a company is permitted to reduce its share capital by section 100 in any of the following ways.

1. By extinguishing or reducing the liability on any of its shares in respect of share capital not paid up

Reducing or extinguishing the uncalled liability of members of the company.

For example, the capital of a company consists of 2,00,000 equity shares of Rs 10 each on which Rs 8 has been paid, now being reduced to a fully paid share of Rs 8.

Journal Entry



2. By paying off any paid up capital which is in excess of the needs of the company

For example, when a company decides to reduce its paid up capital by paying off the necessary amount out of accumulated surplus.

Journal Entries

| Share Capital A/c To Shareholders A/c (Being the amount to be repaid to shareholders on of paid up capital) | Dr. reduction | 1,60,000 | 1,60,000 |
|---|---------------|----------|----------|
| Shareholders A/c To Bank A/c (Being the amount paid off) | Dr. | 1,60,000 | 1,60,000 |
| Surplus A/c To General Reserve A/c (Being transfer on repayment of share capital) | Dr. | 1,60,000 | 1,60,000 |

3. Where any paid up share capital is being reduced with Or without reducing the liability on shares

(1) Reduction in paid up value & Nominal Value Share capital A/c (old face value) and the lead with the Companies Act deal with the C To Share capital A/c (New face value) To bins estimotomos to emerios s To Reconstruction A/c (2) Reduction in paid up value only (no change in the nominal value of shares). Share Capital A/c (Amount of reduction) Dr. To Capital Reduction A/c To Reconstruction A/c

Procedure for reducing Share capital

The main legal requirements for reduction of share capital are summarized as follows:

- 1. The scheme is authorized by articles of association and passed by a special resolution of the general meeting and confirmed by the court.
- 2. The scheme does not effect the creditors interest in any way. If the proposed scheme affects the interest of the creditors, the court/government shall confirm the scheme only after consulting the creditors.
- 3. The government shall pass the order of confirmation of internal reconstruction on such terms and conditions as it may think proper and just after consulting the creditors. If some of the creditors are unwilling the company will have to settle their claims. The court may sanction scheme if the company secures whole of the debts or amount fixed by the court.
- 4. The court may order the use of word "and reduced" after the name of the company and may order the company to publish the reason of such reduction.
- 5. The order of the court has to be filed with the registrar.
- 6. The registrar will then register the order and the minutes.
- 7. After registration, the resolution to reduce the share capital shall take effect.

In following cases, procedure of reduction of capital in not called for:

- ▶ Where redeemable preference shares are redeemed in accordance with the provision of Section 55.
- Where any shares are forfeited for non-payment of calls.
- Where there is surrender of shares or a gift is made to company of its own shares.
- Where the nominal share capital of company is reduced by cancelling any shares which have not been taken or agreed to be taken by any person.

Compromise/ Arrangements

A scheme of compromise/ arrangement is an agreement between a company and its members and outside liabilities when the company faces financial problems. Such an arrangement involves sacrifices to be made by shareholders or creditors or debenture holders or by all

Surrender of Shares

Shareholders may surrender their shares in some situations. These shares may then be allotted to creditors or debenture holders so that their liabilities are reduced. The unutilized surrendered shares are then cancelled.