

Kinds of Share Capital (Sec 43)

1. JJ Irani Committee report

The Companies Act was amended in the year 2000 for providing issue of equity shares with differential voting rights. However, the Committee noted that there was a lack of clarity in the Rules. Also, there were no corresponding amendments effected in Section 87 of the Act. As a result, no corporate could avail of the benefits of this provision. The Committee felt that introduction of concept of shares with differential voting rights should be retained. However, clarity should be brought about in the framework of associated rules to enable proper use of such instrument.

1) And is inserted between clause (a) and (b) of Explanation ii to Section 43 to avoid ambiguity with respect to rights attached to preference shares

2) There shall be two kinds of share capital namely equity share capital (with voting rights or with differential rights as to dividend, voting or otherwise) and preference share capital (preferential right for payment of dividend and repayment of capital at the time of winding up).

2. Scope of Section

Share capital is of two kinds-Preference and equity share capital. A preference share, which receive dividends before ordinary shares but which have no voting rights, it must satisfy the following conditions:

1. as regards dividends, it must carry a preferential right to a fixed amount or amount calculated at a fixed rate and

2. as regards the capital, in the event of a winding up or other arrangement to repayment of capital, there must be a preferential right to be repaid the amount of the capital paid up on such share. Preference share capital may or may not carry such other rights as specified.

All share capital, not falling within the above description of preference capital, is equity share capital, which has no guaranteed amount of dividend but carries voting rights.

Some illustrative rights attached to the equity shares are:

1) right to vote

2) right to receive dividends

3) right to transfer freely without restriction the share to another. The Equity share capital is sub divided into shares with equal voting rights and shares with differential voting rights as to dividend, voting or otherwise.

One another aspect which demands attention is that the Section uses the words 'company limited by shares'. After referring to the definition given under clause (22) of Section 2, one may get the impression that this section does not seek to cover companies limited by guarantee but having share capital. However, after reference to the Notes on Clauses for the Companies Bill, 2011 which states that "This clause seeks to provide that there shall be two kinds of share capital namely equity share capital and preference share capital.", it could be concluded that the legislature does not imply to differentiate between the applicability of the provisions of this Section once share capital is present.

3. Equity Share capital:

Equity share capital as explained in the section means all share capital which is not preference shares capital. It is a residuary definition. It seems other than preference share capital, the company can't have any other capital except equity share capital. Apart from explanation given in this section, there is no exact definition either in this section or other section of the Act prescribed for expression 'equity share capital'. Equity capital is also known as "common stock" or common share capital that represents ownership in a company. Common share capital is generally divided into units known shares. These unit holders are called equity shareholders. They are the real owners of the company and policy makers of the company. However, they do not have access to the day to day affairs of the company. They appoint their representatives called board of directors to look after the affairs of the Company. Equity shareholders are entitled to vote on resolutions of the company, get a return by way of dividend if declared and take part in surplus in assets of the company at time of winding-up.

4. Newer forms of equity capital

Due to constant change in business environment, need of huge private capital, government policy on liberalisation and globalisation of Indian economy, India started witnessing the cross broader investments into Indian Companies. These cross broader investors having exposure to various economics across globe started demanding issue of hybrid instruments (like convertible preference shares, convertible debentures, equity with or without or differential voting rights) for investment made in India to safeguard their money, mitigate risk associated to kind of investment with expectation of a minimum return and wealth maximization by way of capital appreciation. In order to regulate the issue of above enumerated equity with voting rights, with differential rights as to dividend, voting or otherwise section 86 was replaced with suitable provisions in the Companies Act 1956 in 2001. In more lucid and consolidated manner same found place in the Companies Act 2013 as well. However, while introducing into the Companies Act, 1956, the said provision was made applicable to only public companies. Whereas in this Act it was initially made applicable to all companies. Due to practical difficulty faced by industry in ease of doing business, subject to a suitable provision in articles, the private company is exempted from applicability of this section with effect from 5th June, 2015. Now private companies are at liberty to issue any kind of securities apart from equity.

The section uses two expressions for the equity capital, 'equity share capital with voting rights' and 'equity share capital with differential rights as to dividend, voting or otherwise'. Equity capital with voting means a simple equity with all features of common stock whereas later expression gives a room for featuring of different rights in terms of voting and in term of dividends. In general, a class of equity shares issued with differential rights may or may not have voting rights but they are compensated with higher rate of dividend than normal shares. In some case equity shares apart from enjoying the regular voting rights may also be entitled to differential rate of dividends say 0.5% extra dividend to be paid over normal equity shares. Neither in the section nor in the rule it is provided whether the manner of the differential rights or voting rights can be attributed to a particular class of equity shares against another class of equity shares. It is purely the discretion of the company through memorandum or through articles of the company to decide the manner and terms of differential rights or voting.

5. Applicability to Private Companies:

In case of private companies as per Notification No.F.no.1/1/2014-CLV dated 05/06/2015, Section 43 of Companies Act, 2013 is not applicable for a private limited company provided Memorandum or Articles of Association of the private company so provides. Hence, private company can by making relevant provision specify the nature of capital which may be combination of both equity and preference.

6. Voting Rights

As per section 47 of the Companies Act, 2013, subject to provisions of this section in case of a company limited by shares, a member is entitled to vote on every resolution of the company. In case of poll the member shall get such votes proportionate to his holding of shares in the company. In other words, a member is entitled to one vote for one share. This is the normal right that is conferred on equity shares. Any deviation from this voting right is considered as differential voting. There are two types of differential voting rights. One is superior voting right to normal voting right (one vote-one share). For instance ten votes for one share. Another one is inferior voting right. For instance 10 voting right for every 20 shares.

7. Shares with differential voting right

The Equity share capital may be sub-divided into shares with equal voting rights and shares with differential voting rights as to dividend, voting or otherwise. In case of public companies the shares with differential voting rights shall not exceed 26% of the total paid up equity shares capital at any point of time, however in case of private companies as per Notification No. F.no.1/1/2014-CLV dated 5th June 2015, Section 43 of Companies Act, 2013 is not applicable for a private limited company provided that Memorandum or Articles of Association of the private company so provide. Having such provision in Memorandum or Articles of Association of the private company is essential, otherwise section 43 is applicable even to private companies. Advantage of having such exemption to private company is that they can have kinds of capital other than equity shares (with voting rights / with differential voting rights) or preference share capital i.e. private company can have different kinds of

share capital like: Promoters' shares / Founders' Shares / Golden shares / Silver shares / Bronze shares / Platinum shares. Such private companies need not comply with the Rules while issuing such shares. This view is reading the exemption given to Section 43 and 47 together. However, ultimately the said shares will be classified either as equity or preference shares.

As per rule 3 of Companies (Share Capital and Debentures) Rules, 2014, existing share capital cannot be converted into differential voting rights and vice versa. The holders of shares with differential voting rights shall be entitled to all the rights such as Bonus shares, Rights shares etc. which the holders of equity share capital are entitled.

As per the explanation to sub-rule (6) of rule 4 of Companies (Share Capital and Debentures) Rules, 2014, which has been amended w.e.f. 18th June, 2014, the differential rights attached to shares issued under the 1956 Act, shall continue to be regulated under the provisions and rules of Companies Act, 1956.

8. Preference share capital:

The expression 'preference share capital' is defined in the explanation provided in the section which means a part of share capital with a preferential right with respect to:

- (i) Payment of dividend is either as a fixed amount or an amount calculated as a fixed rate which may be free of or subject to income-tax; and
- (ii) repayment of the capital either fully paid-up or partly paid at the time of winding up or fully paid-up at time of redemption.

Further the preference share capital may have another right with respect to

- (i) participate further in the distribution of dividend either fully or partly along with equity shareholder and/or
- (ii) participate further in the remaining surplus along with equity shareholder after entire capital of the company repaid.

9. No Deemed Preference share Capital

As per para (iii) to the explanation to section it is mentioned as 'capital is deemed as 'preference share capital' however this deeming fiction mandates basic rights of preference shares as well. The phrase 'In addition to the preference rights.....' confines this view. Hence there is no deemed preference share capital unless such share capital is issued with basic rights of preference share capital. In a way, the preference shares must carry preferential rights as given in clause (a) and (b) of Explanation (ii) to Section 47. 10. Various types of Preference Shares

There are various kinds of preference shares, which can be issued by a company.

1. Cumulative Preference shares;
2. Non-cumulative Preference shares;
3. Redeemable Preference shares;

4. Convertible Preference shares;
5. Non-convertible Preference shares.

10. Can we have Preference shares without equity shares?

The answer is no. The term 'preference' denotes in ordinary sense as priority, favour, choice, privilege, exception treatment etc. In order to exercise choice or privilege, there should be more than one thing. Only then one can select which one he wants to have. Similarly in any company, preference shares being exceptional shares can't exist alone or be issued without having issued common or equity shares. The exception to rule can't survive alone without rule.

In case of Bihar State Financial Corporation v CIT (1976)46 Comp. Cases 155(Pat), the Patna High Court ruled that there must be at least two kinds of shares in which one class is given a preferential treatment over the other and the rate of dividends once being fixed to be preferentially paid to a such a class of shareholders those shareholders are not entitled to participate in the profits to any extent more than that which is fixed.

Preference share capital is entitled to rights in respect to dividend in addition to preferential rights to the amounts specified.
