

COMAPANY LAW STUDY MATERIAL (LAW 507)

UNIT III

(MAJOR DOCUMENTS OF A COMPANY)

BY

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UNIT 3

FINANCIAL ARRANGEMENTS

3.1. NATURE AND CLASSIFICATION OF COMPANY SECURITIES

“Securities” refers to substitutable and tradable financial instruments with a particular monetary value. This represents the ownership of a listed company through its shares. For laymen, securities are financial assets of monetary value that investors use to invest in a company, while companies use them to raise capital. In India, securities are defined under the [Securities Contracts \(Regulatory\) Act of 1956](#). Under [Section 2 \(h\)](#), securities include “shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporates. Companies Act 2013 also refers to the exact definition, and under Section 2 (81), securities have the same meaning as defined above.

The most common examples of company securities are stocks and bonds. In addition to commodities, securities offer investors the opportunity to increase the value of their money. The value of securities can fluctuate due to various factors. Securities can be broadly divided into four types based on their function and operation. These [four types are equity securities, debt securities, derivative securities, and hybrid securities](#).

A. EQUITY SECURITIES

Equity securities represent the ownership of shareholders of a company (company, partnership, or trust). They are realized in the form of equity capital shares, including both common stock and preferred stock. Equity securities holders are usually not entitled to regular payments. In contrast, equity securities often pay dividends but benefit from capital gains (if their value increases) when the securities are sold, they may receive it. Equity Securities gives holders some control over the company through voting rights. In the event of bankruptcy, they will only receive a portion of the remaining interest after all debt has been repaid to the creditor. It may also be provided as a



payment method. Equity securities can increase or decrease in value depending on the company's performance and the financial markets.

B. DEBT SECURITIES

Debt securities represent borrowings that need to be repaid and are subject to conditions that determine the loan's size, interest rate, and due date or renewal date. Debt securities, including government bonds, corporate bonds, certificates of deposit (CD), and collateralized debt obligations (such as CDOs and CMOS), typically pay the regular holder interest and repay the principal (regardless of the issuer). Give the right. `Performance) Furthermore, all other contractually agreed rights (not including voting rights) and usually issued for some time, after which the issuer can repay. Debt securities can be secured (backed by collateral) or unsecured, and with collateral, they can be contractually prioritized over other unsecured subordinated bonds in the event of bankruptcy.

The mechanism of this bond is to issue a bond of a specific value with a period in which the company promises to pay the amount specified in the bond. The value that a company promises to pay later is usually higher than the value of the bonds offered and gives investors an incentive to buy the bonds. Bonds are called zero-coupon bonds or bonds, depending on whether the bond is sold below par or at par, but the increase in value is based on interest.

Let us look at an example. If the school district wants to build a new school, it can issue a loan to fund the project. Investors who buy bonds borrow money from the school district, hoping to be repaid through interest. This scheme is suitable for both investors and bond issuers. Bonds are less volatile than stocks and help balance the investment portfolio. Companies that issue bonds also receive loans to meet their financial needs.

C. Derivatives securities

It is a financial instrument whose value depends on another underlying financial



instrument or another underlying promise or contract. It is called a derivative because its value is derived from another promise, contract, or financial instruments such as a stock or bond. In the past, derivatives have been used to ensure a balanced exchange rate for internationally traded commodities. International traders needed an accounting system to lock various home currencies at a particular exchange rate. Swaps, futures contracts, and options are examples of derivative securities.

Apart from these three kinds of securities, there is also a fourth kind of security used which does not fall into any of the heads mentioned above because of its nature, called hybrid security.

D. Hybrid securities

As the name implies, hybrid securities are a combination of some of the characteristics of debt and capital. Examples of hybrid securities are warrants (an option that gives shareholders the right to buy shares at a specified price within a specified time), convertible bonds (corporate bonds that can be converted into the issuer's common stock), and preferred stock. These are defined under Section 2 (19A) of the Companies Act, 1956 as "any security which has the character of more than one type of security, including their derivatives" These are hence called 'hybrids' because they have mixed characteristics of both equity and debt.

The Supreme Court dealt with the issue of whether 'hybrid' securities are 'securities' as per the scheme of the Companies Act and SEBI Act in the case of *Sahara India Real Estate Corporation Limited & Ors. v. SEBI*

In this case, the Supreme Court held that 'hybrid securities' are securities within the meaning of the Companies Act, Securities Contracts Regulation Act and hence the SEBI Act.

It based its decision on the fact that Section 2 (h) of the Securities Contracts Regulation Act, 1956 defines securities to include "shares, scrips, stocks, bonds, debenture stocks,



or other marketable securities of like nature in or of any incorporated company or other body corporate” and that the term ‘hybrids’ has been defined as ‘any security having the character of more than one type of security and since these securities are ‘marketable’ they would fall within the meaning of securities for Companies Act, Securities Contracts Regulation Act and the SEBI Act.

Examples of hybrid securities are preferred stock that allows holders to receive dividends before holders of common stock, convertible bonds that can be converted to a known number of shares during the bond’s life or at the maturity date of the contract and so on. Hybrid securities are a complex product. Even experienced investors can find it challenging to understand and assess the risks associated with a transaction. Institutional investors may not understand the terms and conditions of the transactions they enter into when purchasing hybrid securities.

OTHER SECURITIES

A. Certified securities

Certified securities are presented in the form of physical paper. Securities can also be held through a direct registration system that records shares. In other words, the transfer agent manages the shares on behalf of the company without a physical certificate.

B. Bearer securities

A bearer security is tradable security and gives shareholders the rights that arise from the security. They are transferred from investor to investor, in some cases by endorsement and delivery. Concerning ownership, bearer securities prior to digitization were always split. Each security represents a separate asset that is legally separated from the other securities on the same issue.

C. Registered securities

The registered documents will include the owner’s name and any other required information registered by the issuer. Registered papers will be transferred by changing



the registration. Registered bonds are not always split. NS. The whole problem forms a single asset, and each security becomes part of the whole. Unsplit securities are essentially substitutable. The share of the secondary market is not always divided.

3.2. SHARES

Shares in a company show the percentage of ownership of a person or member in that company, which is a single unit that is further divided into several units with their own price. All of these units are of a specific amount, and when someone purchases these units, they also purchase certain defined units of the share capital of the company, which makes that person a shareholder in the company. The term share has been defined under Section 2(84) of the Act, which means a share in the share capital of the company and includes stock. It signifies the interests of the shareholders in the company, measured for the purposes of liability and dividends. A share, debenture, or any interest held by a member of a company is deemed movable property and can be transferred as stipulated in the company's articles of association. A member has the option to transfer any "other interest" in the company following the procedures outlined in the articles.

3.2.1. ALLOTMENT OF SHARES

Allotment of shares is the procedure followed by a company to give its shares to the investor in an exchange for a purchase offer to signify the act of allotting. The investors make the offer through application forms or prospectus supplied by the company for these shares, and the acceptance of this application by the company amounts to the allotment of the shares.

The court in the case of [*Sri Gopal Jalan & Co. v. Calcutta Stock Exchange Association Ltd, \(1964\)*](#) defined the allotment of shares as the appropriation of the unappropriated capital of the company by giving a certain number of shares to certain people.

► *Procedure for allotment of shares*



- Before allotting the shares to new shareholders, the company must take into account the shares allotted to the existing shareholders and analyse how much more shares it should give out;
- The board of directors will hold a meeting to pass a resolution for the allotment of shares;
- The company has to sign the Form MGT-14 and the special resolution passed with the register of the companies;
- The secretary then makes the necessary arrangements with company's bank for collecting the money to issue the letters of allotment to the investors, mentioning the shares allotted to them;
- If necessary, the company has to file a return of allotment form within 30 days of the allotment along with the name and address of the allottees, value of shares, amount paid, and amount payable;
- The company needs to prepare the register of members in accordance with [Section 88](#) of the Act;
- The person either gets issued a share certificate or they can see the allotment of their shares in their Demat account.

3.2.2 TRANSFER AND TRANSMISSION OF SHARES

A transfer of shares is done when a shareholder transfers shares to another person in the form of a gift or sale. This transfer, when done by law, particularly by inheritance, is known as the transmission of shares, which is caused by either death or insolvency of the shareholder. [Section 56](#) of the Act lays down the procedure for the transfer of shares and states that a deceased shareholder's shares can be transmitted through a legal representative even if he is not a member.

The basic difference between the transfer and transmission of shares is that the former is a voluntary act and the latter is an operation of the law. Transfer of shares requires



the existence of a stamp duty, unlike the transmission of shares, which even a private listed company cannot refuse. The transferee does not have the same amount of liabilities that the transferor will have in the process of transferring shares, though in the transmission of shares, the original liabilities apply. While the transfer of shares is not permitted during a lock-in period, the transmission of shares takes place even during lock-in because it is an operation of the law. Transmission of shares does not require any operation or interference of the court of law, though the transfer of shares cannot be possible without an official liquidator.

3.3. SHARE CAPITAL

Share capital refers to the capital raised by the company by issuing common or preferred stock, as the case may be. It is not important for a company to have a share capital; the case might be that it is a company limited by guarantee. The amount contributed by the shareholders is dependent on them, and they can buy shares divided into equal amounts. Simply put, share capital is the total value of funds raised by a company through the issuance of shares to its shareholders.

✦ Authorised capital

The Memorandum of Association of a company states the amount and division of share capital in the company. This amount is called the authorised or nominal capital of the company as per Section 2(8) of the Act.

✦ Issued capital

Section 4(1)(e)(i) of the Act mentions that this share capital is present in the capital clause of the memorandum, which can be issued depending upon the requirements. The portion of this share capital that is issued to the public is known as the 'issued capital,' which is distributed from time to time through subscriptions.

✦ Subscribed capital

The part of the issued capital that is subscribed by the public is called the 'subscribed capital', which, as per Section 2(86) of the Act, is the part of the share capital that is



subscribed by the members for the time being. The minimum subscription requirement presently is ninety percent of the issued capital, and the company has flexibility in calling the subscribed capital.

❖ *Paid-up capital*

The actual amount that the company receives from the subscribed capital is called the 'paid-up capital' as per [Section 2\(64\)](#) of the Act, and the capital that forms the 'uncalled share capital' can be set aside as 'reserve share capital.'

❖ *Called-up capital*

The part of the subscribed capital that the company calls up for payment is called the 'called-up capital' as per [Section 2\(15\)](#) of the Act.

3.3.1 KINDS OF SHARE CAPITAL IN COMPANY LAW

[Section 43](#) of the Act mentions the two types of share capital that a company can have:

- Equity share capital
 1. With voting rights
 2. With differential rights as in dividends, voting, or any other in accordance with the rules prescribed.
- Preference share capital ,unless otherwise specified by the company's Articles of Association (AOA) or Memorandum of Association (MOA).



❖ EQUITY SHARES

Equity share capital means all share capital that is not preference share capital, which represents ownership in a company. All equity shareholders are eligible to voting rights in the company and are eligible for a share of the company's profits, thus bearing a high risk with the possibility of higher returns as well. The dividend that the shareholders get is not fixed in equity shares, and the company might not give any profits to its equity shareholders even if it has them. Though, as per [Section 43\(a\)](#) and [Section 50\(2\)](#), all equity shareholders get a right to vote on every resolution that is passed in the company, and their voting can be determined by the pool of paid-up capital until otherwise provided by the AOA and MOA.

Equity share capital is divided on the basis of differential (dividend) and voting rights, with the former providing the shareholders with much fewer voting rights. Long term, small investors can reduce their voting power to make up for the difference and seek higher dividends.

❖ PREFERENCE SHARES

Preference shares are the shares where the shareholders get preferential rights related to the capital they hold and a dividend over equity shares. Preference shares are shares with a fixed rate of dividend and preferential rights over ordinary equity shares. People who buy preferential share capital get priority in dividend declarations, and at the time of winding up, they are the first ones to receive money. They have the right to vote only when the matter directly or indirectly affects them. This dividend may be a fixed amount that is payable to the shareholders to give them preference over the equity shareholders and to give them a higher claim over the assets of the company without the privilege of voting rights.

Preference shareholders can only vote on resolutions that directly concern them or affect their rights as preference shareholders or the winding up of the company. If the preference dividend is not paid for two years or more, the preference shareholders will get the right to vote on every resolution.



In summary, preference share capital with reference to any company limited by shares means that part of the issued share capital of the company that carries or would carry a preferential right with respect to:

- Payment of dividend, either as a fixed amount or an amount calculated at a fixed rate, which may either be free of or subject to income-tax; and
- Repayment, in the case of a winding up or repayment of capital, of the amount of the share capital paid-up or deemed to have been paid-up, whether or not there is a preferential right to the payment of any fixed premium or premium on any fixed scale, specified in the memorandum or articles of the company.

3.3.3 REDUCTION OF SHARE CAPITAL AND DEMATERIALIZATION

Reduction of share capital refers to the reduction of the issued, paid-up, and subscribed share capital of the company as laid down under [Section 66](#) of the Act. The buyback and redemption of preference shares are also considered as the reduction of capital and do not require approval from the Tribunal. The reduction of the share capital for the company is subject to confirmation by the National Company Law Tribunal (NCLT).

Dematerialisation is a process by which the physical share certificate of an investor is taken back by the company in exchange for an equivalent amount of securities in electronic form. The investor opens an account with the depository participant, who then requests the dematerialisation of the share certificate so that the dematerialised holdings can be credited into the investor's account. This process is optional, and the investor can still hold his shares in physical form. Though the investor will still have to demat the shares if he wishes to sell them through the same stock exchange. If an investor purchases shares, he will get the delivery of those shares in the form of a demat.

Investors have to trade in a dematerialised form to trade in the shares of a listed company, and the company enlists its shares with the depositories. The [Depositories Act, 1996](#), set up two depositories in India:



- [National Securities Depository Limited \(NSDL\)](#)
- [Central Depository Services \(India\) Limited \(CDSL\)](#)

There are several advantages to a depository system:

- Paper forms of shares that are held can be lost, damaged, or stolen easily, which can be avoided through the depository system.
- Shares under this system are held in electronic form, similar to bank accounts, which makes trading for these shares easier.
- Trading in the shares of a company has also been mandated by SEBI under the compulsory Demat segment.
- Banks prefer dematerialised securities to provide credit facilities because demat securities attract lower margins and rates of interest compared to physical securities.

3.4. DIVIDENDS AND PAYMENTS

The dividend is the return on the share capital that shareholders subscribe to and pay to a company. [Section 2\(35\)](#) of the [Companies Act of 2013](#) defines the term 'dividend' as "dividend includes any interim dividend". A dividend, according to the dictionary, is a sum paid to creditors of an insolvent estate or an individual's share of it as loan interest or profit. However, in business parlance, a dividend is the portion of the company's profit distributed to its members.

There is a very minute difference between an interim dividend and a final dividend. While a final dividend is a liability for the company and can be enforced once it is declared by members of the general meeting, a declaration of an interim dividend by the board does not create a liability and can be cancelled at any time before the interim dividend is actually paid out. Even if a portion of the interim dividend has been deposited into a separate bank account, the cancellation can still be performed. The board has the authority to declare an additional interim dividend, and the interim dividend is not



subject to the approval of the members at the general meeting.

According to clause 81 of Table F of the Companies Act of 2013, the board may, subject to [Section 123](#), pay interim dividends to members as it deems appropriate in light of the company's profit.

However, the Department of Company Affairs issued a position regarding interim dividends, stating that the general meeting has the authority to approve dividends, and the board can pay interim dividends if authorised by the articles of association, subject to the company regularising interim dividends at the general meeting. However, these are not legally binding.

Dividends can be paid out of profits from the current year, profits from prior years, or both. Let's say that even if a company has lost money this year, it can still pay dividends if profits from previous years haven't been distributed.

Additionally, dividends may be paid out of the profits made in the current year even if the company has a negative balance in its profit and loss account at the beginning of the current year and earns a profit in that year, but the profit is insufficient to cover the losses of the previous year (i.e., the profit and loss account shows a negative balance after accounting for the profit of the current year).

Also, in case of non-payment of dividends shall be administered by SEBI in the case of listed public companies and public companies intending to list their securities on any recognized stock exchange in India.

FREQUENTLY ASKED QUESTIONS (FAQS)

- ▶ Can a dividend be paid out of the assets of the company?

Dividends cannot be paid out of the assets of the company and generally, can be declared only out of the profit available for the purpose.

- ▶ What is prescribed under Schedule XIV for the rates of depreciation of various assets under the 'straight line method'?

Schedule XIV provides the rate of depreciation of various assets under the straight line



method for single shift, double shift and triple shift basis.

- ▶ Can dividends be paid in cash and kind?

According to Section 205(3), dividends can be paid only in cash and not in kind.

3.5. DEBENTURES

Securities are issued by companies to acquire capital from investors. A security is a negotiable instrument issued by a company or a government which has a certain monetary value to acquire capital from the persons who invest in it. There are three types of securities in company law – a) equity securities which give the equity share value as a security to the person who is investing; b) derivatives securities which give value through another financial instrument or promise or contract and, c) the debt securities which gives the creditor a value through an instrument which comes with a charge on the assets provided as a collateral or security.

Debentures are a type of debt securities issued by a company and are one of the best ways for a company to acquire capital without diluting its ownership or equity values. Debenture has its own features with respect to both the companies and the debenture-holders. It is good for the company as it helps the company to acquire capital without diluting any of its ownership, and it is also good for the debenture-holders as they are secured through their right to charge. A more detailed analysis of debentures is given below in the article.

Meaning of debentures according to Companies Act, 2013

A debenture is a type of debt instrument which is issued by a company to raise capital. Debenture is a long-term debt instrument which may be in the form of a bond or a loan which is secured by the charge upon the assets which have been provided as securities. Debentures have a fixed rate of interest and other characteristics which are described in detail later in the article.



According to [Section 2\(30\) of the Companies Act, 2013](#) – the term “debenture” includes debenture stock, bonds, or any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not. The definition in the Companies Act, 2013 does not mandate the creation of a charge. So, a debenture can be issued without creating a charge on the company’s assets. For example, unsecured debentures are issued without creating a charge, where the company is not required to provide any property or asset as a security for the debt amount acquired by issuing the debentures.

TYPES OF DEBENTURES

Debentures are several types and each has its own features and characteristics. The different types of debentures are listed below.

- Debentures based on security
- Debentures based on tenure
- Debentures based on conversion
- Debentures based on registration

Debenture based on security

Usually, the debenture-holder has less or no risk for the amount he has lent to the company to get the debentures since he has securities to charge, upon the default of payment by the company. The debentures based on security are of two types – secured and unsecured debentures.

- Secured debentures

Secured debentures are also known as mortgage debentures. They are a type of debenture that are secured by a charge either fixed, or floating, on a company’s assets. The holder of this type of debenture has the right to recover the principal amount and the interest from the assets which have been given as securities.

- Unsecured debentures



In this type of debenture, the companies are not required to pledge any of their properties or assets as collateral for the debt amount. Since the unsecured debentures do not require any assets to be used as a security, the lender usually is at high risk of losing his principal amount in case the company defaults. This type of debenture has a high rate of interest.

Debentures based on tenure

Redemption of the debenture occurs when on the maturity date, the company pays back the principal amount along with the interest and releases its properties or assets from the charge given to the debenture-holder. It is divided into two types – redeemable and irredeemable debentures.

- Redeemable debentures

Most of the debentures are redeemable, meaning on the expiry of the maturity date, the debenture is redeemed by the company by paying back the principal amount with interest to the debenture-holder and releasing its assets from charge.

- Perpetual or Irredeemable debentures

If a debenture does not contain any clause as to the payment of the principal amount by the company and redeeming the debenture, then it is known as a perpetual or irredeemable debenture. This type of debentures, unlike redeemable debentures, does not cease on the maturity date.

Debentures based on conversion

The company has the right to convert the debentures into equity shares. There are two types of conversion of debentures – convertible and non-convertible debentures.

- Convertible debentures

The company issuing debentures has the right to convert these types of debentures into equity shares. So the debenture-holder who was just a creditor to the company becomes a member of the company and enjoys ownership of the company to the extent to which he has the equity shares of the company.



- Non-convertible debentures

This type of debenture cannot be converted into equity shares of the company. So the debentures will always be redeemed and will never have the characteristics of equity shares of the company.

Debentures based on registration

As most of the important deeds and instruments of a company are usually registered in the company, debentures are no exception. There are two types – registered and unregistered debentures.

- Registered debentures

If debentures are issued by the company, the company is required to maintain a register of its debenture-holders as [Section 88 of the Companies Act, 2013](#) provides that every company shall register the holders of its debentures. Both, the debenture certificate and the company's register, shall have the name of the debenture holder.

- Unregistered or Bearer debentures

The company can avoid the registration of the debenture-holders if it issues the debentures to the bearer. Such types of debentures are transferable, like negotiable instruments, by way of simple delivery and are also called debentures payable to the bearer.

SHARE-HOLDERS AND DEBENTURE-HOLDERES

In most of the financial aspects, shares and debentures are similar in nature. Both shares and debentures are used by the company in the course of raising their capital to improve their business. In a company both the shares and debentures have certain common functions in any business transactions.



Similarities between shares and debentures

- Both the shareholders and the debenture-holders play the roles of investors as they invest their money in the company.
- Both the shareholders and the debenture-holders also get something in return from the company for the money they have invested in it.
- As both the shares and the debentures are the fundraising tools for the company, they can be issued to the public. Both the shares and debentures can also be sold or purchased in an open market.
- Both the shareholders and the debenture-holders depend upon the assets of the company as securities for the money they have invested in the company.

DIFFERENCES BETWEEN SHARES AND DEBENTURES

| Serial No. | Basis of Difference | Debentures | Shares |
|-------------------|----------------------------|---|---|
| 1. | Role in the company | The debenture-holder just plays the role of creditor of the company. | The shareholder acts as a member of the company. |
| 2. | Ownership | The issuing of debentures does not affect the ownership of the company. | The issuing of shares dilutes the ownership of the company. |
| 3. | Risk | The debentures are generally risk-free. | The Shares are a risky venture of investing in a company. |
| 4. | Return | The debenture-holder | The shareholder gets |



| | | | |
|----|-----------------------|---|---|
| | | gets a fixed amount of interest from the company for the principal they have invested till the date of maturity | returns in the form of dividends, the dividends are issued when the company is in profit. |
| 5. | Transformation | A debenture can be transformed into shares, which are also known as convertible debentures | A share cannot be transformed into debentures |
| 6. | Security | A debenture is secured by a way of charge on the assets provided by the company as collateral | A share is not as secure as a debenture as they are based on the market trends and the performance of the company |
| 7. | Function of a company | A debenture-holder cannot take part in any function of a company. | A shareholder being a member of the company can take part in the functions of the company. |
| 8. | Right to vote | A debenture-holder does not have the right to vote in the company meetings | A shareholder has the right to vote in the company meetings. |

FREQUENTLY ASKED QUESTIONS (FAQS)

1. Can a company buy its own debentures?



A company can buy or purchase its own debentures in the open market. Companies do so with the motive of investing in them and at a later period of time selling them at a higher price and earning a profit thereby. According to [Section 68](#) of the Companies Act, 2013 and [Section 17](#) of the Companies (Share Capital and Debentures) Rules, 2014 defines the procedure for buyback of securities by a company.

2. What is the time period to redeem debentures?

There is as such no time period to redeem debentures, it may vary from company to company but most of the time, the redemption happens after the maturity date. It may be a fixed number of years, any time after a stipulated number of years has passed since its issue or any time after the debenture-holder has issued a notice showing his intention to get back his principal amount through annual drawing.

3. What is the role of a debenture trust deed in debentures?

The debenture trust deed is an instrument which is in favour of the debenture holder and is executed by the company. The company in the trust deed defines its role and duties in the issue of debentures and protects the interest of the debenture-holders.

4. Are debentures and bonds the same?

Generally speaking, all debentures are bonds, but not all bonds are debentures. When a bond is unsecured it is considered a debenture. Debentures are basically used for a specific purpose, unlike bonds. For example, a bond may be issued to raise the capital of the company in general, whereas a debenture may be issued to raise capital for any specific upcoming project of the company. Also in case of the convertible debentures, the convertible debentures can be converted into shares, but bonds can never be converted into shares. Another major difference is that the bonds are issued for a long period of time as compared to debentures that are issued for a short period.

5. Any tax liability to a debenture-holder while redeeming debentures?

If a debenture-holder has invested in bonds or debentures, then he needs to file an Income Tax Return (ITR) and pay tax on the income received when the debenture gets redeemed by him. As per the Income Tax Act, 1961, debentures are considered as



securities and they can be sold, and the sale of debentures is considered as a capital gains income. In terms of listed and unlisted debentures for short term capital gains, there is a tax slab in the Act and in terms of listed and unlisted debentures for long term capital gains, the tax rate is 10% and 20% respectively without indexation under [Section 112 of the Income Tax Act, 1961](#).

RIGHTS AND REMEDIES AVAILABLE TO THE DEBENTURE HOLDER

[Rule 18 \(1\) \(c\) of the Companies \(Share Capital and Debentures\) Rules, 2014](#), specifies that a debenture trustee shall be appointed by the company before the issue also known as “SEBI SCDR, 2014” of a prospectus or a letter of offer for subscription of debentures and no later than sixty days after allotment.

Rule 18 (3) of the SEBI SCDR, 2014 defines the duty of the debenture trustee as follows :

:-

- (a) To ensure that the letter of offer contains no matter that is inconsistent with the terms of the issue of the debentures or the trust deed;
 - (b) Make sure that the trust deed’s covenants do not prejudicially affect debenture holders’ interests;
 - (c) Request periodic status or performance reports from the company;
 - (d) Inform the holders of the debentures promptly if there is a default in the payment of interest or redemption of the debentures and what action has been taken by the trustee;
 - (e) They can appoint a nominee director in the Board of the company in the event of—any default regarding the redemption of debentures or interest payments, as well as any action taken by the trustee himself.
1. According to [Section 71\(8\) of the Companies Act, 2013](#), debenture holders are entitled to interest and redemption on their debentures by the terms of their issue.
 2. As per Section 71(10) of the Companies Act, 2013 if the company fails to pay the



interest due or redeem debentures on their maturity date, the Tribunal can, after hearing the parties involved and requesting relief from the debenture trustee, direct the company to redeem the debentures.

According to Section 71 Sub-section (12) of the Company Act, 2013 a decree for specific performance may be used to enforce a contract with a company to take up and pay for debentures of the company. The Central Government may prescribe the procedure for securing the issue of debentures, the form of the debenture trust deed, the procedure for debenture holders to inspect and obtain copies of the trust deed, quantum of debenture redemption reserve required to be created, and any other matters.

1. Section 164(2) of the Companies Act, 2013 provides a rule for the disqualification of directors for a period of one year or more if they fail to redeem their debentures on the maturity date. The individual who is responsible for non-compliance shall be barred from serving as a director of that company or any other company for the next 5 years from the date on which the company fails to redeem the debentures.
2. According to [Section 186\(8\) of the Companies Act of 2013](#), companies who have not repaid deposits or made interest payments are prohibited from making loans or guaranteeing acquisitions until the default is resolved.

3.6. BORROWINGS AND EFFECTS OF UNAUTHORISED BORROWINGS

Borrowing is an external source of raising money. A company cannot borrow money until it is so authorised by its memorandum.

Under [Section 179](#) of the Companies Act, 2013, the directors have the power to pass a resolution to borrow money and the power to borrow money can be delegated only by passing a resolution.

Under [Section 180](#) of the Act, the directors are restricted from borrowing temporary loans that are obtained from the company's banker. This section also defines temporary loans as the loans which are repayable on demand within 6 months from the date.



Unauthorised Borrowings

It refers to those borrowings which are made without the authority or beyond the amount prescribed in the article. Thus, borrowings beyond the prescribed authority are ultra vires (here, the authority can be either expressed or implied).

Consequences of unauthorised borrowings are:

1. **No Loan:** An ultra vires lender has no legal debt against the company. Such borrowings are forbidden on the grounds of public policy.
2. **Injunction:** If the money advanced by the lender to the company has not been spent then the lender can obtain an injunction to restrain the company from spending it.
3. **Subrogation:** The total indebtedness of a company remains unaffected when a lawful debt has been paid off with an ultra vires loan. In this way, the ultra vires lender is protected against the loss and the burden of the company is not increased.
4. **Identification and Tracing:** If the money of the ultra vires lender is with the company in its original form and is still capable of identification, then he can claim the money from the company.

Types of Borrowings

1. **Long term Borrowing:** The funds are borrowed for a period of five years or more.
2. **Short term Borrowing:** The funds are borrowed for a short period of up to one year. Meeting the working capital needs is the main purpose of these funds.
3. **Medium-term Borrowing:** The funds are borrowed from a period of two to five years.
4. **Secured Borrowing:** Under this, if a creditor has the re-course of assets of the company then a debt obligation is considered as a security.
5. **Unsecured Borrowing:** Under this, the debt consists of financial obligation.



6. **Syndicated Borrowing:** Under this, a group of lenders provides a large fund to the borrowers.
7. **Bilateral Borrowing:** Under this, the borrowing is made from a particular financial institution, by a particular company. It is the opposite of syndicate borrowing.
8. **Private borrowing:** Under this, the company takes a loan from the bank of a financial institution. It consists of bank loan obligations.
9. **Public Borrowing:** Under this, all financial institutions are freely tradable on a public exchange.

INSIDER TRADING

Insider Trading is a practice of using confidential information (unpublished price-sensitive information) of a company to trade in the company's securities. The unpublished price-sensitive information is not known to the general public as it is not published and is related to the decisions taken by the Board of Directors of the company. The use of such information to cause wrongful gain or loss is termed as insider trading. The information is referred to as 'price-sensitive' as it is capable of influencing a company's securities' price in the market.

"Insider trading is an act of buying, selling, subscribing or agreeing to subscribe in the securities of a company, directly or indirectly, by the key management personnel or the director of the company who is anticipated to have access to Unpublished Price Sensitive Information with reference to securities of the company and it is deemed to be insider trading."

Who is an insider?

Any person having any kind of professional or business relationship may become a connected person and thereby an insider, if he may reasonably be expected to have access to unpublished price-sensitive information. The relationship and accessibility to unpublished price-sensitive information facilitated by such a relationship are necessary.



What are the effects of insider trading?

The effect of insider trading is borne by those who are not aware of the confidential information. Due to this, they do not deal in securities. Insider trading is unethical and amounts to a breach of fiduciary position as it involves a breach of trust and confidence. The misuse of insider information is discouraged for numerous reasons:

- a) Insider takes unfair advantage over the information deprived person;
- b) It results in a conflict of interest as it is beneficial for insider's self-interest and not in the company's best interest;
- c) It lowers the market reputation and acts as a disincentive to investment.

The conditional buying or selling of securities by the advantageous person only when in possession of confidential information affects the determination of the value of those securities. Also, the possession of confidential information in question implies that the advantageous person has some connection in the corporation who is yielding the essential information to that person. He may be a director, employee, or professional adviser of that company. This is disadvantageous for the corporation as well.



