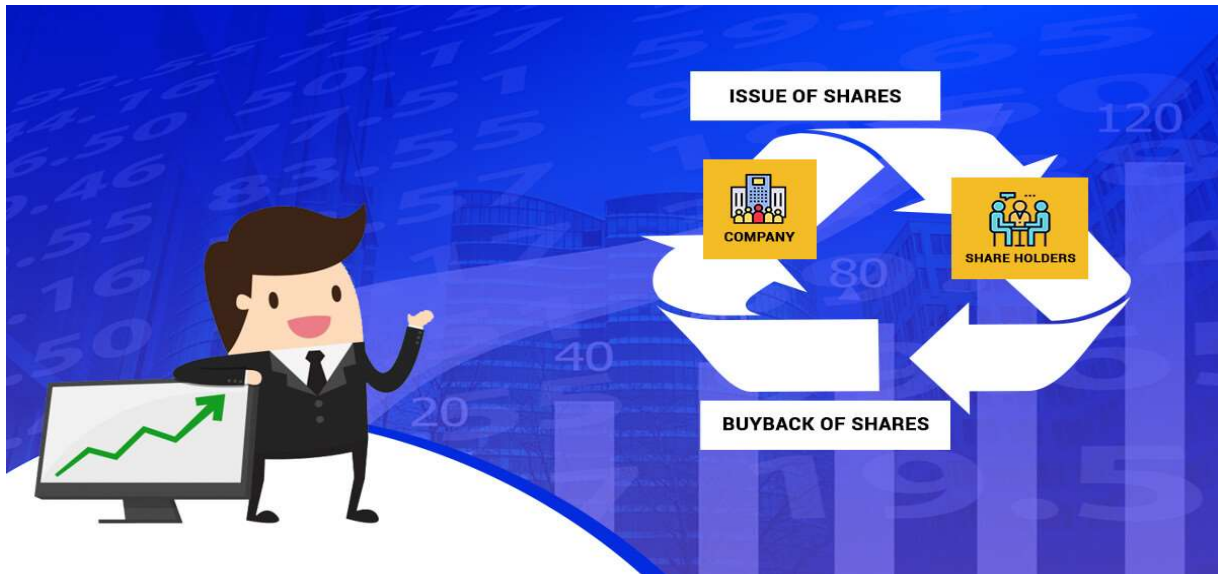


## Buy-back of shares and other specified securities of unlisted Companies



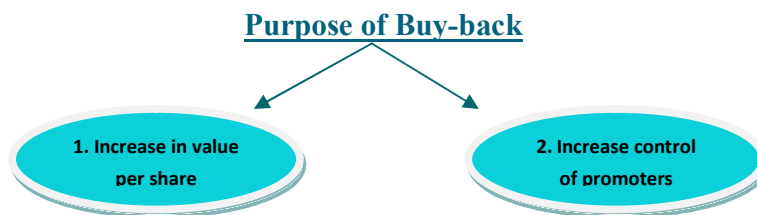
### What is Buy-back?

Buy-back means purchasing own shares or other specified securities by the Company from its existing shareholders or security holders.

### Purpose and Advantage of Buy-back

Purpose and advantage of Buy-back depends upon case to case and type of the Company.

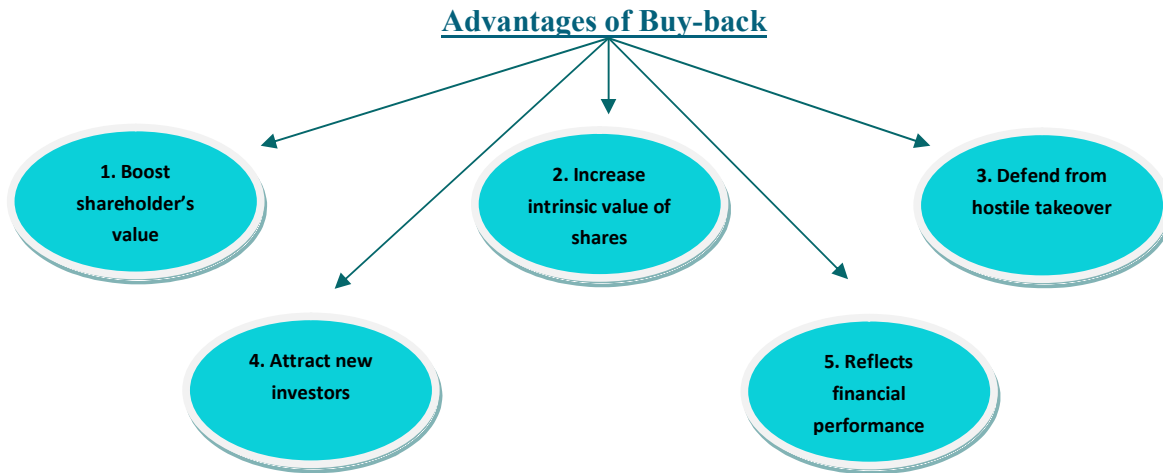
Below chart and the instances put forth therein in each case, would help us understand and critically analyze the purpose and advantage of Buy-back:



For instance;

1. Whenever a Company raises funds, it values the enterprise to get the value per share. When the number of shares reduces, it increases the value per share. For example: the value of enterprise is Rs. 1,00,000/- and there 1,000 share in the share capital of the Company, then value per share is Rs. 100/-. If the Company Buy-back its 200 shares then number of shares in shares capital reduced to 800 and value per share increases to Rs. 125/-.

2. The control over the company is determined by the percentage of shares held by a particular shareholder. Where non-promoter shareholders, are holding more than 50% of share capital of a Company, then promoters of the Company cannot take key decisions like appointment and removal of Directors, declaration of dividend etc.



**For instance;**

1. As explained above increased value per shares also boosts the overall value of the shareholder. For example: as stated above before Buy-back a shareholder was holding 50 shares then his value is Rs. 5,000/- (50\*100), however, after Buy-back his holding reduced to 45 but his value is Rs. 5,625/- (45\*125).

2. The intrinsic value of shares is calculated through following formula:

$$\frac{\text{Value of total assets} - \text{Outside liabilities}}{\text{Numbers of shares}}$$

After the Buy-back, numbers of shares get reduced; accordingly, it increases the intrinsic value per share.

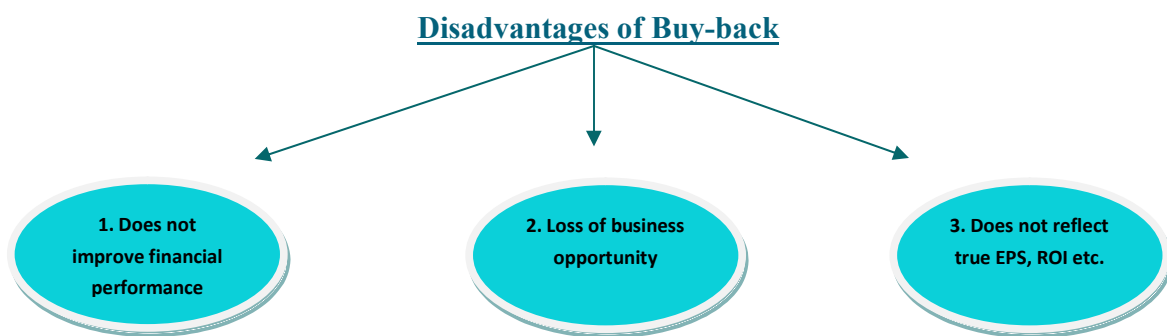
3. When the large portion of share capital is hold by the outsider, then there are more chances of hostile takeover of the Company. Hostile takeover is a situation where other Company or a big investor, without the consent of the promoters of the target Company, gives offer to shareholders of the target Company to sell their shares at a higher price in this situation the outsider shareholder may sell their shares. The Reduction of shareholding of outsiders reduces the chances of hostile takeover.

4. Usually, a Company makes Buy-back of its shares on a higher price than fair market value or book value, or higher price than on which that shares were issued. This practice always gives good return on investment, which makes the Company attractive for investment.

5. The Buy-back usually is made out of retained earnings or reserves of the Company, which is created from the profits of the Company, accordingly, the Buy-back reflects the financial performance of the Company.

### **Disadvantages of Buy-back**

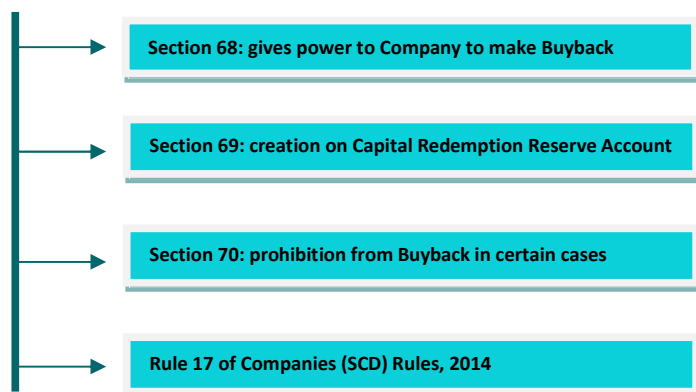
For the following reasons, the Buy-back is criticized.



1. Though the Buy-back reflects the financial performance of the Company, increases value of shares and attracts new investors but it does not increase the revenue of the Company.
2. As discussed earlier the Company makes Buy-back out of its retained earnings or reserves, which could be utilised for expansion of business, but the Company is using that money for making Buy-back, in result the Company loses the business opportunity.
3. We have discussed in purpose and advantage of the Buy-back that Buy-back increases the Earning Per Share (EPS), intrinsic value per share and return on investment etc. but the same is increased due to decrease in number of shares, not due to increase in revenue of the Company, accordingly it does not reflect the true EPS, ROI etc.

### **Governing Sections and Rules of Buy-back**

The Regulatory, Procedural and Compliance requirements of the Buy-back are governed by the Companies Act, 2013 under following sections:





\*Proceeds from earlier issue of share or others specified securities cannot be used for making Buy-back of same class of shares or other specified securities.

Further, the Company cannot utilize any money borrowed from banks or financial institutions for the purpose of buying back its **shares**.

### **Limit of Buy-back**

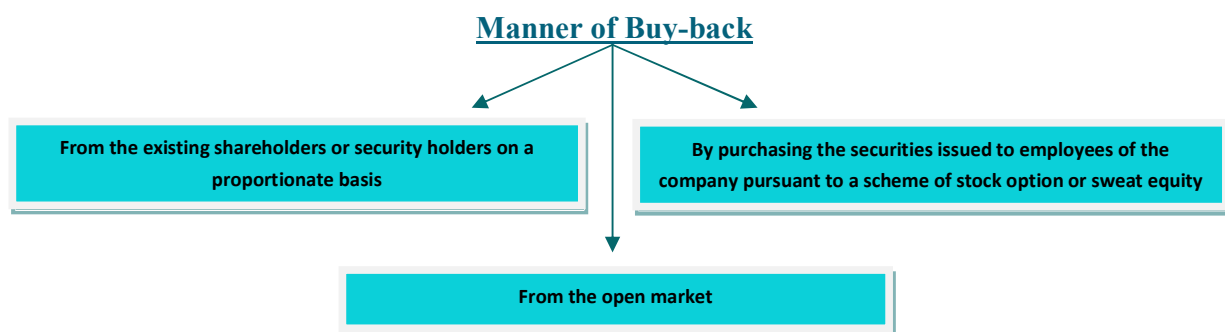
Board of Directors through Board Resolution.	Upto 10% of the Paid up <b>Equity Capital</b> and Free Reserve.
Shareholders through Special Resolution.	Upto 25% of the <b>Paid up Capital</b> and Free Reserve.

*However, in case of Buy-back of Equity Shares, Company cannot make Buy-back exceeding 25% of Paid up Equity Capital in a financial Year.*

### **Conditions for Buy-back**

- Authorised by the Articles of Association of the Company.
- After Buy-back secured and unsecured debts of the Company cannot exceed twice of the Paid up Capital and Free Reserve. That is to say that post Buy-back Debt-Equity ratio cannot exceed 2:1.
- All the shares or other specified securities for Buy-back are fully paid-up.
- The Company cannot make Buy-back within one year from the date of completion of previous Buy-back.
- Post Buy-back the Company cannot issue same class of Shares or Securities including allotment of new Shares upto 6 months except by way of a Bonus issue or in the discharge of subsisting obligation such as conversion of warrants, Stock Option Scheme, Sweat Equity or conversion of Preference Shares or Debentures into Equity Shares.
- The Company cannot withdraw the offer once it has announced the offer to the shareholders.
- Buy-back must be completed within one year from the date of passing resolution by Board or Member, as the case may be.

- The letter of offer shall contain true, factual and material information and shall not contain any misleading information and must state that the directors of the company accept the responsibility for the information contained in such document.
- The company shall not issue any new shares including by way of bonus shares from the date of passing of **special resolution** authorizing the Buy-back till the date of the closure of the offer under these rules, except those arising out of any outstanding convertible instruments.
- The company shall confirm in its offer the opening of a separate bank account adequately funded for this purpose and to pay the consideration only by way of cash.



### **Valuation aspects**

For the purpose of Buy-back the Company has to determine price of share or other specified securities, however neither Section 68 of the Act nor Rule 17 of Companies SCD Rules contains any express provisions regarding method of valuation; further the Section 247 of Act contains the general provisions in respect of valuation. The Section 147 states that where a valuation is required to be made under the Act in respect of shares, securities, property, goodwill etc. it shall be done by a registered valuer.

Nevertheless, Section 68 of the Act states that ‘NOTWITHSTANDING ANYTHING CONTAINED IN THIS ACT’ which implies that this section has an overriding effect in case of a contradiction with any other provision of Companies Act 2013.

It is to be observed that a co-joint reading of Section 68, Section 247 of the Act and Rule 17 of the Companies SCD Rules, precisely concludes that;

Valuation Report in case of Buy-back is not mandatory, however the Rule 17 of the Companies SCD Rules prescribed that the Company has to disclose the basis of Buy-back price in the explanatory statement of the General Meeting, therefore, it is advisable to get the valuation report in respect of Buy-back price from registered valuer or Chartered Accountant who has experience in valuation aspect.

Further question arises that whether a Company can make Buy-back of shares below Fair Market Value (FMV) or Book Value (for unlisted Company)?

This is a debatable question that whether a Company can Buy-back its shares below FMV or Book Value. The Companies Act, 2013 as well as Income Tax Act is salient in this matter.

Further, the ITAT Mumbai Bench in the matter of Vora Financial Services P. Ltd. **[2018] 171 ITD 646 (Mum)** held that buy back of shares is not covered under the ambit of section 56(2)(viia). It was observed that for the purpose of taxing Buy-back under section 56(2)(viia), shares should become "property" of recipient-company whereas in case of Buy-back, such shares are mandatorily cancelled and cannot become property of a company. Accordingly, buy back of shares should be out of the ambit of section 56(2)(viia) of the Act.

In the given case the Company had made Buy-back of shares at price below than FMV and the assessing offer of the income tax has charged income tax on such difference under Section 56(2)(viia) of the Income Tax Act.

Creation of Capital Redemption Reserve Account

In case of Buy-back of Shares out of Free Reserve or Securities Premium Account then sum equal to nominal amount of Shares so bought back required to transfer in Capital Redemption Reserve.

**Prohibition from making Buy-back**

The Company cannot directly or indirectly make Buy-back:

- Through any subsidiary company including its own subsidiary companies.
- Through any investment company or group of investment companies.
- If a default, is made by the Company, in the repayment of Deposits accepted either before or after the commencement of this Act, interest payment thereon, redemption of Debentures or Preference Shares or payment of Dividend to any Shareholder, or repayment of any term loan or interest payable thereon to any Financial Institution or Banking Company:  
However, if the default is remedied and a period of three years has lapsed after such default ceased to subsist, the Company can make Buy-back.
- Where Company has not complied with the provisions of sections 92 (Annual Return), 123 (Declaration of Dividend), 127 (Punishment for failure to distribute Dividend) and section 129 (Financial Statement).

Further, where the unlisted public Company made default under Rule 9A(5) of the Companies PAS Rules, 2014, it cannot make Buy-back of its securities. The said Rule 9A(5) provides that a unlisted public Company shall ensure that:

- It makes timely payment of fees (admission as well as annual) to the depository and registrar to an issue and share transfer agent in accordance with the agreement executed between the parties;
- It maintains security deposit at all times, of not less than two years, fees with the depository and registrar to an issue and share transfer agent in such form as may be agreed between the parties; and
- It complies with the regulations or directions or guidelines or circulars, if any, issued by the securities and Exchange Board or Depository from time to time with respect to dematerialisation of shares of unlisted public companies and matters incidental or related thereto.

#### **Dematerialization Aspect:**

Now securities of unlisted public Company are required to be kept in dematerialized form, accordingly, compliances of regulations, directions, guidelines, and circulars issued by the SEBI and Depository required to be made by the unlisted public Company. Where the unlisted public Company takes decision of Buy-back, it has to immediately inform the Depository, Depository Participant and Registrar & Share Transfer Agent.

#### **Procedure of Buy-back**

Although, both Board of Directors and Members of the Company, have power to make Buy-back, subject to the limit as mentioned hereinabove, but the procedure of the Buy-back is same in both cases.

<b>Buy-back above 10% of Paid up <b>Equity Capital</b> &amp; Free Reserve and upto 25% of the <b>Paid up Capital</b> and Free Reserve.</b>	<b>Buy-back upto 10% of the Paid up <b>Equity Capital</b> and Free Reserve</b>
<b>Approval By Members through Special Resolution</b>	<b>Approval By Board through Board Resolution</b>
Dispatch Notice of Board Meeting	Same
Hold Board Meeting and pass resolutions: <ul style="list-style-type: none"> <li>➤ Approve Buy-back</li> <li>➤ Approve Letter of Offer</li> <li>➤ Approve Notice to call and hold General Meeting</li> </ul>	Same  But the notice for shareholder's approval not required as Board resolution is sufficient in such cases.
	Immediately inform the Depository, Depository

	Participant and Registrar & Share Transfer Agent. <u>(in case of unlisted public Company)</u>
Dispatch Notice of General Meeting	Not required
Hold EGM and approve Buy-back	Not required
Immediately inform the Depository, Depository Participant and Registrar & Share Transfer Agent. <u>(in case of unlisted public Company)</u>	
File letter of offer with ROC in form SH-8 in case Buy-back of shares.	<u>The Rule 17 of the Companies SCD Rules expressly states that SH-8 is required to file in case of Buy-back of shares by Members through Special Resolution, accordingly in case of Buy-back of shares by Board through Board Resolution SH-8 is not required to file, however it is advisable to file the same in this case as well.</u>
File declaration of solvency along with letter of offer with ROC in SH-9	Same
Dispatch letter of offer to shareholder or security holder within 21 days from the date of filing of SH-8 with ROC.	Same
Open offer period for not less than 15 days and for not more than 30 days.	Same
Complete verification of application received within 15 days from the date of closure of offer period. (it is deemed that all application has been accepted by the Company unless communication of rejection has been made within 21 days from the closure of offer period)	Same
Immediately after closure of offer period open a separate Bank Account and deposit amount payable.	Same
Make payment or return share certificates whose application has been rejected, within 7 days from the completion of verification of application.	Same
Extinguish and physically destroy the shares or securities so bought back within seven days of the last date of completion of Buy-back.	Same
Maintain a register of shares or other securities which have been bought-back in Form SH-10.	Same
File form SH-11 (Return of Buy-back) along	Same



with SH-15 (Certificate of Compliance) with ROC within 30 days from the completion of Buy-back.	
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### **Taxation Aspect**

Under Section 115QA of the Income Tax Act, the Company is liable to pay tax on the amount of Buy-back of **shares** @20% including Surcharge and Cess (effective rate is 23.296%). Further, amount received by the shareholder in Buy-back of **shares** is exempted from tax under Section 10(35A) of the Income Tax Act in hands of shareholder.

### **Content of explanatory statement**

#### **Disclosure as per Section 68 of the Act:**

- (a) A full and complete disclosure of all material facts;
- (b) The necessity for the Buy-back;
- (c) The class of shares or securities intended to be purchased under the Buy-back;
- (d) The amount to be invested under the Buy-back;
- (e) The time-limit for completion of Buy-back;

#### **Additional disclosures as per Rule 17(1) of the SCD Rules:**

- (f) The date of the Board Meeting at which the proposal for Buy-back was approved by the Board of Directors of the Company;
- (g) The objective of the Buy-back;
- (h) The class of shares or other securities intended to be purchased under the Buy-back;
- (i) The number of securities that the Company proposes to Buy-back;
- (j) The method to be adopted for the Buy-back;
- (k) The price at which the Buy-back of shares or other securities shall be made;
- (l) The basis of arriving at the Buy-back price;
- (m) The maximum amount to be paid for the Buy-back and the sources of funds from which the Buy-back would be financed;
- (n) The time-limit for the completion of Buy-back;
- (o) (i) The aggregate shareholding of the promoters and of the directors of the promoter, where the promoter is a company and of the directors and key managerial personnel as on the date of the notice convening the general meeting;
- (ii) The aggregate number of equity shares purchased or sold by persons mentioned in sub-clause (i) during a period of twelve months preceding the date of the board meeting at which the Buy-back was approved and from that date till the date of notice convening the general meeting;

(iii) The maximum and minimum price at which purchases and sales referred to in sub-clause (ii) were made along with the relevant date;

(p) If the persons mentioned in sub-clause (i) of clause (o) intend to tender their shares for Buy-back –

(i) The quantum of shares proposed to be tendered;

(ii) the details of their transactions and their holdings for the last twelve months prior to the date of the board meeting at which the Buy-back was approved including information of number of shares acquired, the price and the date of acquisition;

(q) A confirmation that there are no defaults subsisting in repayment of deposits, interest payment thereon, redemption of debentures or payment of interest thereon or redemption of preference shares or payment of dividend due to any shareholder, or repayment of any term loans or interest payable thereon to any financial institution or banking company;

(r) A confirmation that the Board of directors have made a full enquiry into the affairs and prospects of the company and that they have formed the opinion-

(i) That immediately following the date on which the general meeting is convened there shall be no grounds on which the company could be found unable to pay its debts;

(ii) As regards its prospects for the year immediately following that date, that, having regard to their intentions with respect to the management of the company's business during that year and to the amount and character of the financial resources which will in their view be available to the company during that year, the company shall be able to meet its liabilities as and when they fall due and shall not be rendered insolvent within a period of one year from that date; and

(iii) The directors have taken into account the liabilities (including prospective and contingent liabilities),

as if the company were being wound up under the provisions of the Companies Act, 2013

(s) A report addressed to the Board of directors by the company's auditors stating that-

(i) They have inquired into the company's state of affairs;

(ii) The amount of the permissible capital payment for the securities in question is in their view properly determined;

(iii) That the audited accounts on the basis of which calculation with reference to buy back is done is not more than six months old from the date of offer document; and

Provided that where the audited accounts are more than six months old, the calculations with reference to buy back shall be on the basis of un-audited accounts not older than six months from the date of offer document which are subjected to limited review by the auditors of the company.

(iv) The Board of directors have formed the opinion as specified in clause (r) on reasonable grounds and that the company, having regard to its state of affairs, shall not be rendered insolvent within a period of one year from that date.

**Checklist for Buy Back of Own Shares or Securities**

S. No.	Particulars	Yes/ No/ NA	Remark
1. (i)	Whether the company is authorised to buy back its shares or securities by Articles of Association (AOA)?		
(ii)	If No, alteration of AOA is to be initiated or not? (AOA has to be amended by passing a Special resolution) File MGT-14 within 30 days.		
2. (i)	What is the quantum of the shares to be bought back?		
(ii)	Have you determined the quantum of buy back of shares?		
3. (i)	If the buy back is less than 10% of paid up equity share capital & free reserve, then Board resolution shall be sufficient, therefore is the Board resolution passed for the same purpose?		
(ii)	But if the buy back is more than 10% as mentioned in point 3(i) but less than 25% of paid up capital and free reserve then Special resolution is required, is it passed?		

(iii)	Whether have you checked that Number of shares to be bought back in respect of Equity shares should not exceed 25% of its total paid up equity share capital in a financial year?		
(iv)	In case of unlisted public Company, whether intimation to Depository, Depository Participant and Registrar & Share Transfer Agent has been made, immediately after passing resolution under point 3(i) or 3(ii)?		
4.	Whether the restrictions related to buy back are checked?		
5.	Whether there is a gap of more than one year from the closure of previous buy back?		
6. (i)	If special resolution is to be passed, whether the notice of the same is given at least 21 days prior to the date of passing the Special Resolution?		
(ii)	Whether Explanatory Statement contains disclosures as per Section 68 and Rule 17(1)?		
(iii)	Whether Form MGT-14 is filed with the registrar along with the fees within 30 days from passing special resolution?		
(iv)	Whether the company has, after passing Special resolution but before buy back of shares, has filed with the Registrar of Companies a letter of offer in Form SH-8?		
(v)	Have you verified that Form SH-8 needs to be signed by at least 2 directors; out of which at least one should be Managing director, if any?		
7. (i)	Whether the Company has, before the Buy-back, files declaration of solvency along with letter of offer in form SH-9?		
(ii)	Have you verified that Form SH-9 needs to be signed by at least 2 directors; out of which at least one should be Managing director, if any?		

(iii)	Whether declaration of solvency has been verified by an affidavit as per Rules?		
8.	Whether have you ensured that letter of offer is dispatched to the Shareholders or security holders within 21 days from its filing with Registrar of Companies?		
9. (i)	Whether have you checked that the offer of buy back has remained open for a period of minimum 15 days and maximum 30 days from the date of dispatch of letter of offer?		
(ii)	If offer period was opened for less than 15 days, then check whether consent of all members of the Company has been obtained?		
10.	If bought back shares are oversubscribed by the shareholders or security holders, whether the acceptance per shareholder is done on proportionate basis out of the total shares offered for being bought back, restricting it to the maximum number of shares to be bought back?		
11.	Whether have you checked that verifications of shares bought back are completed from the date of closure of the offer of the offers received within 15 days?		
12.	If the shares are to be rejected whether the communication for rejection of shares has been made within 21 days from the date of closure of offer?		
13.	Has the company immediately after the closure of the offer, opened a bank account and deposited therein the total amount payable as consideration for the shares offered for buy back?		
14.	Whether within 7 days from completion of verification of records, has the company made payment?		
15. (i)	Whether Company has extinguished and physically destroyed the shares and securities so bought back from the shareholders?		

(ii)	Whether shares certificate of rejected application has been returned?		
16.	Whether within 14 days from the date of Buy-back of shares Company has paid additional tax u/s 115QA @ 20% on distributed income?		
17.	Has the company maintained a register of shares or other securities which have been bought-back in Form SH-10?		
18.	Where is the register maintained & in how's custody, who is making entries in that register, is these question in accordance with the provision of Section 68 or not?		
19. (i)	Has the company, after the completion of the Buy-back, filed with the Registrar, a return in the Form SH-11 within thirty days of completion of buy back?		
(ii)	Is there annexed a certificate in Form SH-15 to the return filed with the Registrar in Form SH-11?		
(iii)	Whether Form SH-15 signed by two Directors of the Company including the managing director, if any, and a Company Secretary in Practice?		
20.	If the company has bought back its shares out of free reserves or securities premium account, a sum equal to the nominal value of the shares so purchased shall be transferred to the capital redemption reserve account?		
21.	Whether the buy back is completed within one year from the date of passing board resolution or Special resolution?		
22.	If there is a default by the company in any of the above mentioned points, whether the company has been informed about the penal provisions relating to Buy-back on company and every officer of the company?		