



Safeguard to the holders of liabilities of a company through Ensuring Adequate Equity: An Analysis of the Provisions of the Companies Act, 2013

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Abstract

This article basically deals with the safeguard provided under the Companies Act, 2013 to the holders of liabilities of a company incorporated under the Companies Act, 2013 by means of ensuring adequate equity. The holders of liabilities of such a company may include the holders of non-current liabilities or the holders of current liabilities. When there is enough equity in a company, the company may easily discharge the dues to the holders of such current liabilities or non-current liabilities. The holders of non-current liabilities include the entities granting long-term and short-term loans to the company and the holders of current liabilities include the entities supplying goods or services to the company related to the ordinary course of activities of the company. In this article, thirteen sections of the Companies Act, 2013 i.e., Section 51, Section 52, Section 53, Section 54, Section 55, Section 61, Section 63, Section 66, Section 67, Section 68, Section 69, Section 70, Section 71 have been discussed in terms of its implications and means of ensuring the safeguard to the holders of liabilities to be discharged in a detailed and analytical manner.

Keywords: The companies act, 2013, company, holders of liabilities, current liabilities, non-current liabilities, equity, etc

Introduction

The Companies Act, 2013 ^[1], through some of its statutory provisions, ensures that the equity of the company is not unduly reduced resulting into the lack of adequate security to the holders of liabilities, especially non-current liabilities. The reason is that when some external parties grant loans to a company, they look into the fact as to how much equity that company has at the time of granting loan to it. When they become satisfied that the company has adequate equity, they grant loan to it. What is stated about the holders of non-current liabilities is also applicable to the holders of current liabilities (e.g., trade creditors etc.) though to a little less extent. Hence, later, after the grant of loan or selling goods to the company on credit basis, if the company reduces the equity (especially share capital), the security available to the holders of liabilities is also reduced going against the interest of those liabilities' holders. To ensure that this does not happen, the Companies Act, 2013 has made adequate provisions, through its various sections and rules. This article analyses those provisions of the Companies Act, 2013 ^[1].

Objective of Study

The objective of the study is to analyse the different provisions of the Companies Act, 2013 in a detailed manner which act as a kind of safeguard to the holders of various non-current liabilities and current liabilities by means of ensuring adequate equity comprising of share capital and reserves and surplus so that the said liabilities may be discharged by the companies as and when they fall due as per their terms and conditions.

Methodology of Study

The various provisions of the Companies Act, 2013 meant for ensuring adequate safety in the form of equity for safeguarding the interest of the holders of liabilities have been studied and analysed as to how they protect the interest of the liabilities holders. Besides, for the purpose of the said

analysis, the websites of the Ministry of Corporate Affairs ^[7], the Institute of Chartered Accountants of India ^[4], the Institute of Company Secretaries of India ^[5] and the Institute of Cost Accountants of India ^[6], study materials published by the ICSI for their executive programme and some standard text books authored by renowned persons meant for professional courses have also been referred to.

Analysis of the Relevant Provisions of the Companies Act, 2013(1)

1. Section 51: Payment of Dividend in Proportion to the Amount Paid

Section 51 states that "The payment of dividend by a company may be made to the shareholders in proportion to the amount paid, if so, authorised by its articles."

This Section refers to the payment of dividend in respect of the shares which are partly paid-up. In some of the cases, the company does not pay dividend in respect of the shares which are partly paid-up. However, if the articles of association of the company so authorise, the company may pay dividend to the shareholders in respect of the partly paid amount regarding the nominal value. This is another safeguard for the holders of liabilities of the company by referring to the fact that a company should normally not pay the dividend at all in respect of the partly paid shares unless the articles so provide. Besides, even if the article provide for the payment of dividend to the shareholders in respect of the partly paid shares, it can provide for payment of dividend only on the actually paid amount in respect of the nominal value of such shares meaning that even the articles of association cannot provide for payment of dividend to the shareholders of partly paid shares for any amount of nominal value yet to be paid by the said shareholders.

2. Section 52: Application of Securities Premium Received on the Issue of Shares

Sub-section 1 of Section 52 states that "if a company issues its shares at a premium, the amount of premium must be

transferred to Securities Premium A/c". Besides, it also provides that the provisions of reduction of share capital will apply if the securities premium account is to be reduced treating it as paid-up share capital if the same is not reduced as per this section.

One of the uses under Sub-section 2 and Sub-section 3 each of Section 52 is the use of securities premium account for the issue of fully paid bonus shares to the members of the company.

Now, if we analyse the implication of Sub-section 1 of Section 52, it puts a very strict restriction on the use of securities premium account. It states that if the company does not reduce the securities premium account as per the provisions of Section 52, it may reduce it only if it applies the provisions of the Companies Act, 2013 ^[1] regarding the reduction of share capital because this Sub-section treats the securities premium account as part of the paid-up share capital.

The analysis of clause (a) Sub-section 2 and Clause (a) of Sub-section 3 each allows the use of securities premium account for the issue of fully paid-up bonus shares to the members of the company making the securities premium account ultimately as part of the paid-up share capital.

We can, therefore, say that the Companies Act, 2013, by means of Section 52 ensures a higher level of safety for the holders of liabilities of the companies by increasing the amount of share capital by capitalising securities premium.

3. Section 53: Prohibition on Issue of Shares at a Discount

Sub-section 1 of Section 53 "prohibits the issue of shares at a discount, except for the sweat equity shares". This is a safety to the holders of liabilities in the sense that if the shares are issued at a discount, the company received the issue price less than the nominal value of the shares, hence, the credit to the Share Capital A/c is not properly represented by the money received by it. The Companies Act, 2013 ^[1] not only prohibits the issue of shares at a discount but also, vide its Sub-section 2 provides that "any issue of shares at a discount by a company shall be void".

Sub-section 2A of this section allows the issue of shares at a discount in an exceptional case. It provides that "a company may issue shares at a discount to its creditors when its debt is converted into shares as per any statutory resolution plan or debt restructuring scheme as per any guidelines or regulations or directions specified by the Reserve Bank of India as per the Reserve Bank of India Act, 1934 ^[2] or The Banking Regulations Act, 1949 ^[3]".

4. Section 54: Issue of Sweat Equity Shares

The Companies Act, 2013, through its Section 54, imposes very strict conditions for the issue of sweat equity shares of a class of shares already issued at a discount. These conditions are as under:

1. The issue is authorised by a special resolution passed by the company;
2. The resolution must specify the number of shares to be so issued, current market price, the consideration, if any, and the class or classes of directors and employees to whom such shares are to be issued at a discount; and
3. If the shares of the company are already listed on a recognised stock exchange, the sweat equity shares must be issued as per the regulations of Securities and Exchange Board of India, and if the shares of the

company are not listed, the same must be issued as per the prescribed rules."

The above provisions of Section 54 impose so many conditions for the issue of sweat equity shares at a discount and these are definitely meant for securing the interest of the holders of liabilities of the company.

5. Section 55: Issue and Redemption of Preference Shares

The three provisos to Section 55 (2) of the Companies Act, 2013 ^[1], related to the redemption of preference shares provide as under:

Proviso (a): "No preference shares shall be redeemed except out of the profits of the company which would otherwise be available for dividend, or out of the proceeds of a fresh issue of shares made for the purpose of redemption of such preference shares";

Proviso (b): "No preference shares shall be redeemed unless they are fully paid";

Proviso (c): "Where preference shares are proposed to be redeemed out of the profit of the company, there shall, out of such profits, be transferred, a sum equal to the nominal value of the preference shares so redeemed, to capital redemption reserve account"; and

Proviso (d): "The premium, if any, payable on redemption of preference shares shall be provided for out of the profits of the company".

Section 55 (4): "The capital redemption reserve account shall be used by the company only for the issue of fully paid-bonus shares to the members of the company."

Analysis of the Implications of the Above Provisions of Section 55:

1. Analysis of Proviso (a) and Proviso (c): These provisos clearly provide that the preference shares shall be redeemed only out of the profits of the company available for dividend or out of the fresh issue of shares made for that purpose. Now, if the company uses profit of the company for the redemption of preference shares, the company will have to transfer an amount equal to the nominal value of preference shares redeemed to capital redemption reserve account (CRR A/c) as per Proviso (c) above and this CRR A/c shall be used for the issue of fully paid-up bonus shares only as per Section 55 (4) of the Act. Thus, the decrease in the share capital of the company by way of redemption of preference shares is fully supplemented by way of increase in share capital by the use of use of CRR A/c for the issue of fully paid-up bonus shares. Thus, the security in the form of adequate equity for the liabilities holders at the time of incurrence of liabilities remains at the same amount even after the redemption of preference shares. Secondly, if the preference shares are redeemed out of the proceeds of fresh issue of shares, the same result is achieved i.e., the reduction in the share capital is supplemented by the fresh issue of shares and hence, the capital amount remains at the same figure as it was before the redemption of

preference shares. Hence, security to the liabilities holders in the form of adequate equity (share capital in this case) is maintained before and after the redemption of preference shares.

2. **Analysis of Proviso (b):** When the liabilities holders provided loan to the company, they also took into consideration the fact that the preference shares though being partly paid will be fully paid in future and hence, they are more secured. Thus, this proviso states that the preference shares will be redeemed only if they are made fully paid. Thus, if the preference shares are partly paid, the holders thereof will be called upon to pay the balance money and only after the payment of the balance money when they become fully paid-up, they will be redeemed. Again, based on the proviso (a), fully paid preference shares will be redeemed and the reduction in the preference share capital will be fully supplemented in either of the two manners as discussed under analysis of proviso (a) and proviso (c) above.
3. **Analysis of Proviso (d):** The proviso (d) above states that if any premium has to be paid on the redemption of preference shares, the same will be provide for out of the profit of the company. The profit of the company in the instant case refers to the revenue profit of the company. The revenue profit of the company is legally owned by the equity shareholders of the company. Hence, any extra amount payable on the redemption of preference share is compensated out of the profit of the company which is owned by the equity shareholders. Thus, in this case, the share capital of the company is not affected at all meaning thereby that the share capital in relation to the payment of premium on redemption of preference shares remains the at the same figure as it was before the redemption of preferences shares. Thus, because of the payment of premium on redemption of preference shares, the security available to the holders of liabilities are not affected at all.

6. Section 61: Power of Limited Company to Alter its Articles

The whole of Section 61 dealing with the matter of alteration of share capital nowhere at all permits the reduction of share capital thereby ensuring that the safety in the form of adequate equity is maintained regarding the liabilities of the holders of the company.

7. Section 63: Issue of Bonus Shares

Sub-section 1 of this section provides that a company may issue fully paid-up bonus shares not only by using the securities premium account and CRR A/c but also by using free reserves. However, Clauses (c), (d) and (e) of Sub-section 2 of this section make provisions regarding the safety of the holders of liabilities. Clause (c) of Section 63(2) states that “a company cannot issue fully paid bonus shares to its members if it defaulted in the payment of interest on fixed deposits or debt securities issued by it.” Clause (d) of Section 63 (2) provides that “a company cannot issue fully paid bonus shares to the members if it defaulted in the payment of statutory dues of the employees such as contribution to provident fund, gratuity or bonus”. Thus, under this clause, the company treats the employees also, in respect of the specified dues to them, at par with the

holders of liabilities of the company. Clause (e) of Section 63 (2) goes even one step forward by providing that the partly paid-up shares must be made fully paid-up before the issue of bonus shares out of the three sources to the members of the company.

Thus, the perusal of Section 63 of the Companies Act, 2013 ensures adequate safety for the holders of the liabilities of the company.

8. Section 66: Reduction of Share Capital

Sub-section 1 of 66 provides that the “company may reduce its share capital in the permitted manner only when the application is made by the company to the Tribunal and the Tribunal confirms the same”. However, the Tribunal confirms the reduction of share capital in a very special circumstance. Sub-section 2 of Section 66 states that “the Tribunal shall give a notice of such application made to it to the various parties including the creditors of the company and will hear the representations made by them.” Sub-section 3 of Section 66 is very important and states that “the Tribunal, inter alia, may pass an order confirming the reduction of share capital only when it is satisfied that the debt or every claim of the company is discharged or has been secured or their consent is obtained”. Thus, Sub-section 3 of Section 66 gives a huge protection to the holders of liabilities so far as the reduction of share capital leading to the reduction of security of the creditors is concerned.

9. Section 67: Reduction on Purchase by Company or Giving of Loans by it for Purchase of its Shares

Sub-section 1 of this section totally prohibits “a company limited by shares or limited by guarantee and having a share capital to buy-back its share unless the reduction of share capital is effected”. However, Section 68 of the company dilutes this provision subject to compliance with certain provisions as is detailed below under section 4.10.

10. Sections 68 and 69: Power of a Company to Purchase its Own Securities and Creation of Capital Redemption Reserve in Certain Cases of Purchase of its Own Securities

Sub-section 1 of Section 68 states that “a company may purchase its own shares or other specified securities” out of any of the three sources. The three sources are free reserves, securities premium and the proceeds of issue of any shares or other specified securities. This sub-section also provides that “if the shares are bought back out of the proceeds of shares or other specified securities”, the same must of a difference kind of shares or securities from the kind of shares or securities to bought back.

However, Section 69 of the Act, is giving a very important safeguard to the holders of liabilities. It provides that “where a company purchases its own shares out of free reserves or securities premium, it shall transfer to Capital Redemption Reserve A/c a sum equal to the nominal value of the shares so purchased.” Besides, Sub-section 2 of Section 69 also states that “the capital redemption reserve account may be used by the company only for the issue of fully paid bonus shares to the members.” Thus, the reduction in the share capital is compensated by the capital redemption reserve account to be used for the issue of fully paid bonus shares alone. Thus, the security to the holders of liabilities is maintained at the same amount as it was before the purchase of its own shares.

11. Section 70: Prohibition on Buy-Back in Certain Circumstances

This section has two sub-sections. Sub-section 1 of Section 70 provides that “no company can buy-back its shares or other specified securities through any subsidiary company or any investment company or group of investment companies.” This sub-section further provides that “a company cannot purchase its own shares or other specified securities if the default is made by the company in the repayment of deposits, interest payment thereon, redemption of preference shares or redemption of debentures, or repayment of any term loan or interest thereon payable to any banking company or financial institution”.

Thus, if we peruse Sub-section 1, it is clear that the Companies Act, 2013 makes it sure that the company does not reduce its share capital unless it pays the liabilities as per the terms and conditions thereof.

12. Section 71: Debentures

Sub-section 4 of Section 71 of the Companies Act, 2013(1) provides that “if a company issues debentures, it shall create a debenture redemption reserve out of the distributable profits of the company and such debenture redemption reserve may be used only for the redemption of the said debentures”.

Sub-section 5 and Sub-section 6 of Section 71 provides for the appointment of debenture trustees for the protection of interest of debenture holders.

Sub-section 7 goes even one step forward by providing that “a company cannot exempt any debenture trustee from his duties to protect the interest of debenture-holders”. Further, a “debenture trustee shall not be careless in his duties towards the debenture holders”.

Sub-section 8 provides that “a company must pay interest on debentures and principal as per the terms and conditions of issue of debentures”.

Sub-section 9 is a very important provision regarding the debenture trustees to be proactive. It states that “where a debenture trustee comes to a conclusion at any time that the assets of the company are insufficient or are likely to become insufficient to discharge the principal amount when it becomes due, the trustee may file a petition before the tribunal and the Tribunal, after hearing the concerned parties, may impose restrictions on the company regarding the incurrence of further liabilities”. This further ensures the safety of debenture holders, a holder of the liabilities of the company.

Sub-section 10 and 12 also provide with tribunal and court with a huge power for protecting the interest of debenture-holders.

Conclusion

This article refers to thirteen sections of the Companies Act, 2013 by analysing the provisions thereof along with the implications of those provisions for the protection of the interest of the liabilities holders of the company by ensuring the adequate equity of the company comprising of share capital and reserves and surplus in relation to the holders of those liabilities.

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