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News Alert on Companies (Share Capital and Debentures) Third Amendment Rules, 2016



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COMPANIES (SHARE CAPITAL AND DEBENTURES) THIRD AMENDMENT RULES, 2016

Ministry of Corporate Affairs (“MCA”) vide notification dated July 19, 2016 has issued Companies (Share Capital and Debentures) Third Amendment Rules, 2016 which shall come into effect from the date of its publication in the official gazette.

In the Companies (Share Capital and Debentures) Third Amendment Rules, 2016 following major amendments are introduced:

1. Sub Rule (1) of Rule (4) of Companies (Share Capital and Debentures) Rules, 2014 lays down various conditions to be complied with by the Company in order to issue equity shares with differential rights as to dividend, voting or otherwise. One of such condition is that there should be no default made by the Company in respect of the following:
 - a. payment of the dividend on preference shares or;
 - b. repayment of any term loan from a public financial institution or State level financial institution or scheduled Bank that has become repayable or interest payable thereon or;
 - c. dues with respect to statutory payments relating to its employees to any authority or;
 - d. default in crediting the amount in Investor Education and Protection Fund to the Central Government;

With the aforesaid amendment notification, a proviso has been inserted **allowing** Companies who have defaulted any of the aforesaid conditions, to **issue equity shares with differential rights after expiry of 5 years from the end of financial year in which default was made good.**

2. As per the Companies (Share Capital and Debentures) Rules, 2014, Companies are permitted to issue sweat equity shares, higher of the following:
 - (i) 15% of the existing paid up equity capital in a year **or**
 - (ii) shares of issue value of Rs. 5 crores;

Now, a **startup Company**, as defined by Department of Industrial Policy and Promotion, **can issue sweat equity shares upto maximum 50% of paid up capital, till 5 years from the date of its incorporation or registration.**

This amendment is a stepping stone towards facilitating the startup Companies to attract and retain the best of the human resources available in the industry.

3. The amendment rules now permits the **startup companies** as defined by Department of Industrial Policy and Promotion to issue shares under a scheme of Employees’ Stock Option (“ESOP”) for a **period of 5 years from the date of its incorporation or registration** to the following:
 - (i) an employee who is a **promoter** or a person belonging to the promoter group; or
 - (ii) a **director** who either himself or through his relative or through any body corporate, directly or indirectly, holds **more than 10%** of the outstanding equity shares of the startup company.

The same was not permitted earlier as aforesaid employees / director were not included in the definition of the employee for the purpose of issuing shares under the scheme of ESOP.

4. Companies can now allot **partly paid securities on preferential basis** as the mandatory requirement of issuing fully paid-up securities has been done away with this amendment rules.
5. Companies issuing **convertible securities on a preferential basis**, now have the following **two option** to determine the price of the equity shares, to be issued upon conversion of the securities;
 - i. determine upfront i.e. at the time of issuing such convertible securities or
 - ii. determine 30 days prior to the date when the holder of convertible security becomes entitled to apply for shares, on the basis of valuation report of the registered valuer. Such valuation shall not be earlier than 60 days of the date when the holder of convertible security becomes entitled to apply for shares.

Provided that the Company shall take a decision on sub-clauses (i) or (ii) at the time of offer of convertible security itself and make such disclosure in the explanatory statement annexed to the notice of general meeting for issuing such convertible securities on preferential basis.

6. **Company not having a share capital** and proposing to increase its number of members will now have to file **Form SH-7** with the Office of Registrar of Companies for intimating such increase in number of members.
7. Companies can now **create a security** by creating charge or mortgage on the properties / assets **of its subsidiaries or its holding company or its associates company for securing the issue of secured Debentures**. Prior to this amendment, the charge was allowed to be created **only** on the properties/assets of the Company issuing such secured Debentures.
8. Now, for the NBFC's registered with RBI, Housing Finance Companies registered with National Housing Bank, Manufacturing and Infrastructure Companies, Debenture Redemption Reserve ("DRR") will be required to be created for an amount of 25% of the value of **outstanding debentures as against the total value of the debentures**. Also a proviso has been inserted which states that higher amount may be transferred to DRR as may be necessary in case of premature redemption of debentures even if it exceeds the limits prescribed i.e. 25%.

The link of the above Notification is as under;

http://www.mca.gov.in/Ministry/pdf/Rules_19072016.pdf

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