

Redemption of Preference Shares

Meaning of Preference Shares:

Preference Shares mean and includes that part of the share capital the holders of which have a preferential right overpayment of dividend (fixed amount or rate) and repayment of share capital in the event of winding up of the company.

Types of Preference Shares

- 1) Based on convertibility
 - a. Convertible Preference Shares
 - b. Non-Convertible Preference Shares
- 2) Based on Permanence
 - a. Redeemable Preference Shares
 - b. Irredeemable Preference Shares

Meaning of Redemption of Preference Shares:

Repaying the capital back to the preference shareholders at an agreed amount on agreed date.

Provisions of the Companies Act

Section 55(2): A company limited by shares may issue preference shares, if so;

- Authorized by its articles
- Which are liable to be redeemed within a period not exceeding twenty years from the date of their issue, subject to such conditions as may be prescribed (except for infrastructure projects which shall start redemption of a minimum 10% of such preference shares per year starting from the 21st year onwards or earlier, on proportionate basis)
- Methods of redemption
 - a. Capitalization of undistributed profits
 - b. Issue of fresh capital
 - c. Combination of [a] and [b]

Redemption of preference shares by fresh issue of shares

Companies Act, 2013 permits for redemption of preference share with fresh issue of Equity shares or Preference shares.

Source for Premium on Redemption

1. Certain class of Companies whose financial statements comply with the Accounting Standards as prescribed under Section 133 of the Companies Act, 2013, it must be out of profits of the company and cannot use existing Security premium or security premium collected on fresh issue for the purpose of redemption.
2. Companies issued shares before the date of commencement of the Companies Act, 2013 or the class of Companies whose financial statements do not comply with the Accounting Standards as prescribed under Section 133 of the Companies Act, 2013 can be made from securities premium or profits of the company.

Applications of Securities premium account (Section 52)

- a. Towards issue of fully paid bonus shares
- b. To write off preliminary expenses
- c. To write off the expenses or, or commission paid, or discount allowed on any of the securities or debentures
- d. To provide for premium on the redemption of redeemable preference shares or debentures of the company
- e. For the purchase of its own shares or other securities.

Note:

1. Only fully paid up preference shares can be redeemed.
2. Redemption does not result in reduction in capital.
3. Capital Redemption Reserve shall be created from the profits of the company to the extent of nominal value of the preference shares redeemed
4. Capital Redemption Reserve can be utilized to issuance of fully paid up bonus shares only.

Accounting Entries:

1	When new shares are issued at par	
	Bank A/c	Dr
	To Share Capital A/c	
2	When new shares are issued at premium	
	Bank A/c	Dr
	To Share Capital A/c	
	To Securities Premium A/c	

3	When preference shares are redeemed at par
	<div> <div>Preference Share Capital A/c</div> <div>Dr</div> </div> <div> <div>To Preference shareholders A/c</div> </div>
4	When preference shares are redeemed at a premium
	<div> <div>Preference Share Capital A/c</div> <div>Dr</div> </div> <div> <div>Premium on Redemption of Preference Shares A/c</div> </div> <div> <div>To Preference shareholders A/c</div> </div>
5	When payment is made to preference shareholders
	<div> <div>Preference Shareholders A/c</div> <div>Dr</div> </div> <div> <div>To Bank A/c</div> </div>
6	For adjustment of premium on redemption
	<div> <div>Profit and Loss A/c</div> <div>Dr</div> </div> <div> <div>To Premium on Redemption of Preference Shares A/c</div> </div>