

Buy-Back of Securities under Companies Act Limits on Consideration or Share Capital?

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Background

Section 68 of Companies Act, 2013 (“CA 2013”) governs Buy-back of Securities. The section provides for the sources, limits and other conditions for Buy-back. Section 68 of CA 2013 is largely a replica of its predecessor, Section 77A of the Companies Act, 1956 (“CA 1956”). However, there is slight difference in the wording in provision relating to limits on Buy-back under Section 68(2)(c) of CA 2013 vs Section 77A(2)(c) of CA 1956. The difference in wording under CA 2013 leads to a debate whether the limit under Section 68(2)(c) is applicable for ‘consideration’ to be paid on Buy-Back or ‘share capital’ or both. In this article, I’ve tried to find an answer to this question.

Comparison of Provision under CA 1956 and CA 2013

As mentioned above, the position which was very clear under CA 1956 becomes debatable under CA 2013. Therefore, it is appropriate to have a very close look at the wording of the provisions.

77A(2)(c) of CA 1956

“The buy-back is or less than twenty-five per cent of the total paid-up capital and free reserves of the company:

Provided that the buy-back of equity shares in any financial year shall not exceed twenty-five per cent of its total paid up equity capital in that financial year”

68(2)(c) of CA 2013

The buy-back is twenty-five per cent. or less of the aggregate of paid-up capital and [free reserves](#) of the company:

Provided that in respect of the buy-back of equity shares in any [financial year](#), the reference to twenty-five per cent. in this clause shall be construed with respect to its total paid-up equity capital in that [financial year](#)”

Careful reading of Section 77A(2)(c) would tell us that while the section talks about ‘consideration’ for Buy-back, the proviso talks about ‘share capital’. Whereas, under Section 68(2)(c), the wording in the proviso “*the reference to twenty-five per cent. in this clause*” suggests that the section as well as proviso talk about ‘consideration’. As such, it can be said that the 25% limit for Buy-back apply only to ‘consideration’ and not to ‘share capital’ (**View 1**). However, a common view in the market seems to be that the 25% limit applies to ‘consideration’ as well as to ‘share capital’ (**View 2**).

Doctrine of Capital Maintenance and Minimum Capital Requirement

Doctrine of capital maintenance restricts ability of the company to return the capital to the shareholders in order to protect the creditors of the Company. While, this doctrine is not expressly referred in Indian

Company Law, it is present in CA 2013 through various provisions like Section 66, 67, 68, 69 etc. as these provision put restrictions on pay back of capital to the shareholders.

Buy-back is a limited capital reduction and is done with the approval of the shareholders where the amount going out i.e. consideration is limited to 25% of the paid up capital and free reserves. This ensures that 75% of the Networth remains within the Company ensuring protection to the creditors of the Company. In case of capital reduction, while there is no restriction on the payment of consideration, it can be done only after confirmation by the NCLT wherein NCLT would ensure that reduction in / payback of capital would not have any impact on any other stakeholder, primarily the creditors. Accordingly, it can be said that the outflow of funds / consideration on Buy-back is important to be regulated and not the number of outstanding shares. Here, it is also important to note that the requirement of minimum paid up capital has been omitted from CA 2013, vide Companies (Amendment) Act, 2015.

Deliberate Change in CA 2013

I was not able to find any specific reference to any discussion on Companies Bill leading to the change in the wording in the proviso from CA 1956 to CA 2013. Even while the reference is not available, it appears that there is a deliberate change in the way the proviso is worded under CA 2013.

Operation of Proviso to Section 68(2)(c)

Having concluded on View 1 being the appropriate view, it would be important to analyze how does the proviso exactly operate. As discussed above, unlike Section 77A(2)(c), Section 68(2)(c) as well as the proviso talk about consideration. What is brought out by the proviso is a specific requirement in case of Buy-back of equity shares. As such, it would be appropriate to say that proviso is relevant only and only if the Company has capital other than equity capital as well. It can be understood better with the help of the following example.

Paid-up Capital and Free Reserves of a Company	
	Amount (INR)
Equity share capital	5,000
Preference share capital	5,000
Free Reserves	10,000
Total paid up capital and free reserves	20,000

- In case of Buy-back of preference shares, the total eligible Buy-back consideration would be INR. 5,000, being 25% of the total paid up share capital and free reserves i.e. INR 20,000.
- In case of Buy-back of equity shares, the total eligible Buy-back consideration would be INR. 3,750, being 25% of the total paid up equity share capital and free reserves i.e. INR 15,000.

Concluding Notes

In consideration of the discussion on doctrine of capital maintenance and based on the understanding of how proviso to Section 68(2)(c) operates, View 1 appears to be appropriate view and taking View 2 (which would be the appropriate view in case of 77A(2)(c) of CA 1956), disregarding the deliberate change under CA 2013 may not be appropriate. Apart from it being aligned with the view under CA 1956, there appears no compelling reason for considering View 2 as the appropriate view.

While I intended to deal with the provisions of CA 2013, it is interesting to note the contrary developments in SEBI Buy-back Regulations 2018^[1]. When SEBI released Buy-back Regulations 2018 replacing the earlier regulations, in terms of limits on Buy-back, in Regulation 4(i) contained an explanation similar to the proviso to Section 68(2)(c) of CA 2013. However, earlier in 2023, by way of amendment regulations, the explanation^[2] is changed to expressly apply 25% limit even to number of shares as well in contradiction of CA 2013.

The 2023 [amendment](#) to SEBI Buy-back Regulations was made on the recommendations in the report of the sub-group on the Securities and Exchange Board of India (Buy-back of Securities) Regulations, 2018^[3]. While the sub-group made this recommendation to specifically limit the number of shares, the report doesn't provide any rationale on this recommendation.

[\[1\]](#) Securities and Exchange Board of India (Buy-Back of Securities) Regulations, 2018

[\[2\]](#) Explanation: In respect of the number of equity shares bought back in any financial year, the maximum limit shall be twenty-five per cent and be construed with respect to the total paid-up equity share capital of the company in that financial year.

[\[3\]](#) Report dated October 20, 2022