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Topic – Issue and Redemption of Preference Shares

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Issue and Redemption of Preference Shares

Preference share are the shares which promise the holders a fixed rate of dividend, whose payment takes priority over that of equity share dividends. Capital raised by the issue of preference share is called preference share capital.

The preference shareholders are in superior position over equity shareholder in two ways. First, receiving a fixed rate of dividend, out of the profits of the company, before any dividend is declared for equity shareholder and seconds receiving their capital after the claims of the company's creditors have been settled, at the time of liquidation. In short, the preference shareholders have a preferential claim over dividend and repayment of capital as compared to equity shareholders. Dividend are payable only at the decretion of the directors and only out of profit after tax, to the extent. These resemble equity shares. Preference shareholders generally do not enjoy any voting rights. In certain cases, preference shareholders may claim voting

rights if the dividends are not paid for two years or more on cumulative preference shares and three years or more on non-cumulative preference shares.

Issue of Preference Share

According to section 55 of companies Act, 2013.

1. No company limited by shares shall, after the commencement of this Act, issue any preference shares which are irredeemable.
2. A company limited by shares may, if so authorised by its articles of association, issue preference shares which are liable to be redeemed within a period not exceeding twenty years from the date of their issue subject to such conditions may be prescribed.

However, a company engaged in the setting up and dealing with of infrastructural projects may issue preference shares for a period exceeding 20 years but not exceeding 30 years.

Rules of issue of preference shares

According companies (share capital and Debentures) Rules, 2014, clause 9 are as follows.

1. Special Resolution-
Before the issue of preference shares, it is necessary to pass a special resolution in the general meeting of the company.
2. No Default in Payment
At the time of such issue of preference shares, the company has no subsisting default either in the redemption of preference shares or in payment of dividend due on preference shares.
3. Details of Preference Shares
A company issuing preference shares shall set out, in the resolution, the following matters relating to such shares.
 - I. The priority with respect of payment of dividend or payment of capital in comparison to equity shares
 - II. The participation in surplus fund
 - III. The participation in surplus assets and profits, on winding up which remain after the entire capital has been repaid.
 - IV. The payment of dividend on cumulative or non-cumulative basis
 - V. The conversion of preference share into equity shares
 - VI. The voting rights
 - VII. The redemption of preference shares.

Redemption of Preference shares

Redemption of preference share means returning the preference share capital amount to the preference shareholders either at a fixed date or after a certain time period during the life time of the company provided, company must comply certain conditions. According to section 53 of companies Act 2013, The following are the important provisions have been laid down in regard to redemption of preference shares.

- i. Company must be authorised by its articles of association.
- ii. Fully paid shares – No such shares shall be redeemed unless they are fully paid up – partly paid up shares cannot be redeemed. If they are partly paid, in that case a final call be made to convert them from partly paid to fully paid only then redemption can be carried out.
- iii. Sources of Redemption - Such redeemable preference shares shall be redeemed
 - a. Out of the profit of the company which would otherwise be available for the dividend
 - b. Out of the proceeds of a fresh issue of shares made for the purpose of redemption.
- iv. Provision of Capital Redemption Reserve Account – If the redeemable preference shares are proposed to be redeemed out of the profits available for the dividend, a sum equal to the nominal amount of the shares to be redeemed must be transferred to reserve account to be called Capital Redemption Reserve Account.
- v. Premium on Redemption of Preference Shares – If the preference shares are redeemed at premium then such premium must be provided either out of profit of the company's Securities Premium Account.
- vi. Conversion into New Preference Shares – Preference shares can be redeemed by converting into preference share or equity share
- vii. Application of the Capital Redemption Reserve Account – According to section 55 (4) the Capital Redemption Reserve Account may be applied by the company in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares.
- viii. Condition of Redemption – A company may redeem its preference share only on the terms of its issued under section 48 they may be redeemed in following condition.
 - a) At a fixed time or on the happening of a particular event.

- b) At any time on the option of company or
- c) Anytime at the option of shareholders.

A. Redemption of Preference Share by company in infrastructural projects.

A company engaged in the setting up and dealing with of infrastructural projects may issue preference shares for a period exceeding 20 years but not exceeding 30 years preference shares per year from the 2nd year exceeds or earlier, on proportionate basis, at the option of preference shareholders.

The Rules Relating to Redemption of Preference Share

1. Redemption out of profit i.e. Divisible profit

Generally the following funds can be used for the redemption of preference shares, is done by making the capital available from under mention account then the expected capital is being transferred first in Capital Redemption Reserve Accounts.

- i. Statement of profit and loss
- ii. Reserve Funds
- iii. General Reserve
- iv. Insurance Fund
- v. Dividend Equalisation Fund
- vi. Workmen's compensation fund
- vii. Workmen's accident fund
- viii. Voluntary debenture redemption account
- ix. Debenture Sinking Fund A/C

Following are the profit not available for redemption of preference shares because these profits are of capitalistic nature

- 1. Security Premium Reserve Account
- 2. Share forfeiture account
- 3. Profit prior to incorporation of a company
- 4. Capital Reserve Account
- 5. Development rebate reserve and
- 6. Investment Allowance Reserve

2. New Issue of Shares

The redemption of preference shares can be done by the capital obtained from new issue of shares either it may be equity share or preference shares. New shares can be issued on equal value or at premium –

- i. If the new shares are issued at par then the share capital can only be used for the redemptiom of reference shares

- II. If the new shares are issued at premium, then the share capital can only be used for the payment of preference shares, the amount of premium can not be used for payment of preference shares capital.

3. Paying the preference shares by issuing new shares and profit

Sometime the redemption of preference shares can be done partially from the profits of the company and partially from the profits of the company and partially by issuing new shares. If the amount of the profit of company given in the question is insufficient, then the balanced capital will be managed from the issue of new shares.

Accounting Treatment For Redemption of Preference Shares

I. Issue of new shares

Bank A/c	Dr
To Share Capital A/C	
To Securities Premium Reserve A/C	
(Being shares issued and cash proceed)	

II. Redemption of preference shares out of divisible profit

Statement of Profit and Loss A/C	Dr
Dividend Equalisation Reserve A/C	Dr
General Reserve/ Reserve Fund A/C	Dr
To Capital Redemption Reserve A/C	
(Being provision made of Capital Redemption Reserve)	

III. Provision of premium on redemption

Securities Premium Reserve A/C	Dr
Statement of Profit and Loss / General Reserve A/C	Dr
To premium on redemption of preference share capital A/C	
(Being provision of premium on redemption of preference share)	

IV. Transfer of redeemable preference share capital to preference shareholders account

Redeemable preference share capital A/C	Dr
premium on redemption of preference share A/C	Dr
To Redeemable preference shareholders A/C	
(Being preference shares redeemed at premium and the amount due to shareholders)	

