

CAPITAL REDEMPTION RESERVE & CAPITAL RESERVE

➤ **CAPITAL REDEMPTION RESERVE**

The provisions relating to the CRR are available in Section 69 of the Companies Act, 2013. Capital Redemption Reserve (CRR) is a requirement under the Companies Act which applies to buy-back schemes and redemptions of preference capital. The requirement should be followed by companies which are redeeming preference capital through any of the three specified modes. They are:-

1. Redemption from distributable profit
2. Redemption through a fresh issue of capital.
3. Combination of Both

➤ **Creation of CRR**

When a company engages in redemption or buy-back of capital, the capital base is reduced.

To compensate for the reduction, the Companies Act provides that a portion of the available reserves should be separately allocated. It makes sure the redemption does not cause any reduction in the shareholders' funds and thus the interest of the external parties remains unaffected. For this, it is needed that the redemption is done by the fresh issue of shares and/or undistributed profits which are transferred to the 'Capital Redemption Reserve Account'.

➤ **Purpose & Utilisation of CRR**

The purpose of the CRR is to ensure that companies maintain the capital base intact in the event of a capital diminution. A capital diminution refers to depletion in the paid-up capital of a company. It can be caused when a company redeems preference capital or opts to undertake a buy-back scheme.

The intention of the requirement to transfer distributable profit to the CRR is to benefit the lenders as well. When the capital base of the company is reduced, the lenders may have apprehensions about the safety of the advances made. To provide security to the lenders, the Companies Act requires companies to maintain the required level of CRR.

Thus, by introducing funds into the CRR, the capital base of the company is retained intact. A capital redemption reserve account can be used to pay any unissued shares of the company to be issued as fully paid bonus shares to the members of the company.

The profit prior to incorporation is also a capital profit and hence not to be used to create the Capital Redemption Reserve. Similarly share forfeiture account also cannot be used for such reserves.

As per sub-section (1) of Section 63 of the Companies Act, 2013, a Company may issue Bonus Shares out of- its free reserves; Securities Premium Account; Capital Redemption Reserve Account. Further, it has been provided that Issue of Bonus Shares shall not be made out of Capitalising Reserves created out of revaluation of Reserves. Free Reserves means such reserves of the Company which is available for distribution as Dividend.

➤ **CAPITAL RESERVE**

Capital reserve has nowhere been specifically defined in the Companies Act, 2013 or anywhere in Accounting Standards but taking the cue of references made of Capital Reserve at various instances in Accounting Standard 12, 14 and elsewhere we can construe that Capital Reserve is generated out of Capital Gains of the Company which may include profit out of sale of undertakings, profit out of revaluation of Capital Assets, profit made on issue of Shares at Premium, etc.

The capital reserve is the reserve created out of the company's profits generated from its non-operating activities during a period and is retained to finance the company's long-term project or write off its capital expenses in the future.

➤ **Creation of CAPITAL RESERVE**

- ⊥ Profit earned on the sale of Fixed Assets.
- ⊥ Profit earned on selling investments.
- ⊥ Profit received on buying an existing business.
- ⊥ Profit generated on the revaluation of assets and liabilities.
- ⊥ Premium received on issuing shares and debentures.

➤ **Purpose & Utilisation of CAPITAL RESERVE**

A capital reserve is an account to prepare the company for unforeseen events like inflation, instability, or the need to expand the business or get into a new and urgent project. It works in quite a different way. When a company sells off its assets and makes a profit, a company can transfer the amount to capital reserve.

Since a company sells many assets and shares and can't always make profits, it is used to mitigate any capital losses or any other long-term contingencies. It has nothing to do with the trading or operations of the business. It is created out of non-trading activities and thus it can never be an indicator of the operational efficiency of the business.

A company's capital reserve is the cash reserved for unexpected short-term expenses. Depending on the business, an adequate capital reserve might cover three to six months' worth of business expenses.

Thus, we may conclude that in order to issue Bonus Shares out of Capital Reserve we need to first check nature of such Capital Reserve. If the profit of the Company which would have been available for distribution as Dividend (Example: sale of Fixed Assets or Sale of Undertaking) had been transferred to Capital Reserve during some year, then that balance of Capital Reserve may be used for issue of Bonus Shares. The only restriction has been levied is on the use Revaluation Reserve for issue of Bonus Shares.