Buy Back of Equity Shares (8 marks)

1) Buy Back means Repayment of amount of Share Capital by Company to Equity Shareholders.

2) Buy Back Reduces the Share Capital of Company.

3) Maximum Buy Back allowed is 25%.
Buy Back is not mandatory.

4) Preference Share Capital :- For PSC, Company can redeem (repayment) the amount to PSH.

Redemption also reduces the Share Capital & it is mandatory for redeemable PSC.
Redemption Limit = 100%.

5) Journal Entries :-

Buy Back	Redemption
1) Eq. Share Capital Dr. — Face value	1) Pref. Share Cap. A/c Dr. — FV
exp. Premium on BB Dr. — Prem. (exp)	Premium on Redemp Dr. — Prem.
To Equity Share BB a/c — (BB price)	To PSH a/c — Redemp. price
2) Equity Share BB Dr.	2) PSH a/c Dr.
To Bank a/c	To Bank

3) Security Premium Dr. 1st priority
General Reserve Dr. 2nd Priority
P&L Dr. 3rd priority
To Premium on BB a/c

4) Sale of Investment for the purpose of BB :-

Bank a/c Dr.
To Investment
(Difference Gain/Loss — P&L)

5) Creation of CRR :-

GR a/c Dr. 1st Priority
P&L a/c Dr. 2nd —"—
SP a/c Dr. 3rd —"—
To CRR

6) Fresh issue of Securities

Bank a/c Dr.
To PSC a/c
To Security Prem. a/c

7) Buy Back exp.

a) BB exp. a/c Dr.
To Bank a/c

b) P&L a/c Dr.
GR a/c Dr.
To BB exp.

3) Security Premium Dr. 1st priority
FR [General Reserve Dr. 2nd Priority
P&L Dr. 3rd priority]
To Premium on Redemption A/c

4) Creation of CRR :-

GR a/c Dr. 1st Priority
P&L a/c Dr. 2nd —"—
SP a/c Dr. 3rd —"—
To CRR

5) Fresh issue of Securities

Bank a/c Dr.
To PSC a/c
To Security Prem. a/c

6) Redemption Exp.

Redemp. exp. Dr.
To Bank

P&L a/c Dr.
GR a/c Dr.
To Redemption exp.

8) Issue of Bonus

CRR a/c Dr. (1st Priority)
SP a/c Dr. (2nd)
GR a/c Dr. (3rd)
P&L a/c Dr. (4th)
To ESC a/c

9) Cancellation of Investm. in own Debn

%. Debentures Dr. — Face Value
To Invst. in own Debn — Cost
To profit on Cancellation — (b/f)

6) Source of Buy Back & Redemption :-

a) Out of Fresh issue proceeds of Other Securities. (eg. Pref. Shares)
issue of Debn/Loan is not allowed.

Cash is available b) out of Securities Premium Balance available;

Cash is available c) Out of General Reserves & P&L Credit Balance.

Note :- Sale of any Investment/Asset for the purpose of BuyBack means Company is Using either SP Balance (or) GR/P&L

Balance as Source of BuyBack.

7) Securities Premium Generated Out of :-

Issue of Equity (or) Pref. Sh. Capital → Can be Utilized

&

Issue of Debentures & Bonds → Can-not be Utilized.

8) Creation of CRR :- (Capital Redemption Reserve)

CRR shall be Created if BuyBack/Redemption is Out of SP/GR/P&L.

(No CRR in Case of Fresh issue)

Amt of CRR = Face Value of BB Shares Utilized out of SP/GR/P&L

CRR shall be Created out of SP/GR/P&L.

Class Ex 1:- Total Equity Shares = 2,00,000 no.
FV = 10/-
General Reserve = 500000
P&L a/c = 4,00,000
SP Bal. = 450000 Cr.

Company decided to buyback 10% equity shares at 30/- each

Solution:-

Total No. of Buy Back @ 10% = 20,000 no.
BB price = 30/-
Total amount of Buy Back = 6,00,000

- Face value of BB 2,00,000
  - Out of Fresh issue → NiL
  - &
  - Out of GR/P&L/SP 200000 → Create CRR out of GR
- Premium on BB 4,00,000 → W/off from SP Bal.

1) ESC a/c Dr. 200000
Premium Dr. 400000
To Eq. Sh. BB a/c 600000

2) Eq. Sh. BB a/c Dr. 600000
To Bank a/c 600000

3) Securities Prem. a/c Dr. 400000
To Premium on BB 400000

4) General Reserve a/c Dr. 200000
To CRR a/c 200000

9) Important Working For BB/Redemption

Total no. of Shares to be bought back —— xxx
(x) BuyBack Price —— xx

Total Amt. of Buy Back —— xxxx

Face value of BB
- 1st Out of Fresh issue proceeds
- &
- 2nd Out of Free Res. & SP (Balance) → CRR of Same amount

Premium on BB → W/off Out of :-
1) SP
2) GR
3) P&L

10) Buy Back Expenses such as Legal & document Charges, if paid then Charge to P&L (or) GR.

11) Utilization of CRR :-

- Can be Utilized to issue Bonus equity Shares at Face Value
- Can not Used to Pay Dividend, to W/off any Exp (or) Premium paid on BB

12) These are not Free Reserves and Can not be Utilized For Buy Back / Redemption :-

Capital Reserve
Revaluation Reserve
Debenture Redemption Reserve
CRR
or any other Statutory Reserve

13) Final Equity Share Capital after BuyBack & Bonus :-

250000	Original Equity Share Capital	xxx
Less :-	Face Value of Buy Back (62500)	(xx)
Add :-	Face value of Bonus issue	xx
	Revised ESC =	xxx

$\frac{187500}{15} \times 3 = +37500$

225000
$\times 20$

14) Buy Back and Redemption is Same Question

Always Solve Redemption working in First priority and then Solve Buy Back working with Remaining Balances of Reserves. (Refer Q203 & Q204)

15) Maximum Permissible Buy Back V. Imp.

We have to apply Following Test to Calculate maximum no. of BuyBack allowed :-

a) Shares O/s Test

Max. Buy Back No. = 25% of Total Issued Equity Shares.

b) Resources Test

Maximum Buy Back Amt. = 25% of $\left(\text{Total } \underbrace{\text{Paid up Capital}}_{\text{ESC + PSC}} + \text{Free Reserves}\right) + \text{SP}$

Free Reserves → GR, P&L

$$\text{Max. BB No.} = \frac{\text{Max. BB Amt}}{\text{BB price}}$$

c) Debt Equity Test

Debt Equity Ratio after the BuyBack Should not exceed 2 : 1

$$\frac{D}{E} = \frac{2}{1}$$

Note:- a) Equity = ESC + PSC + FR + SP

b) Debt = LT + ST Borrowings

eg. Debentures | Bonds | Loans

Current Equity (before BB) Less Buy Back effect (Reduction of Equity) = Minimum Equity after BB (as per 2:1 D/E)

Class Example Current Structure of a Company:-

ESC = ₹ 80 lacs. − 10x (10/- each)

PSC = ₹ 25 lacs.

GR = ₹ 30 lacs. − 10x

P&L = ₹ 50 lacs.

SP = ₹ 15 lacs. − 40x

No effect

LT Borrowings = ₹ 1,60,00,000

ST Borrowings = ₹ 90,00,000

Proposed Buy Back price = 50/- Per Share

Solution Suppose "x" is maximum no. of BB

a) **BB effect** :- Reduction of ESC = 10x

Creation of CRR = 10x

W/off premium out of FR/SP = 40x

60x

b) Current Equity

$$
\begin{aligned}
ESC &= 80,00,000 \\
PSC &= 25,00,000 \\
SP &= 15,00,000 \\
GR &= 30,00,000 \\
P\&L &= 50,00,000 \\
\hline
& \quad 2,00,00,000
\end{aligned}
$$

c) $\text{Minimum equity } (2:1) = \dfrac{\text{Debt}}{2} = \dfrac{2,50,00,000}{2}$

$= 1,25,00,000$

Current Equity − BB effect = Minimum equity after BB

$2,00,00,000 - 60x = 1,25,00,000$

$x = 125000$ no.

Maximum Permissible BuyBack will be Lower of Following Test:-

a) Shares O/s Test
b) Resource Test
c) Debt Equity Test