Chapter: IV

NATURE OF SHARES
01 BACK GROUND NATURE OF SHARES

01.01 In Chapter III while discussing skill required of an appraiser we concluded that the appraiser should cultivate the art and capacity to reach to the core or essentials of the problem of valuation. In other words, perspicacity should be one of the essential qualities that an appraiser should have. This is essential because an appraiser must know exactly the various elements of the appraisal assignment. This is more important when appraisal or valuation of shares in a company for fiscal purposes is involved. The identification of interest in property would enable the appraiser to reach to the core or the essential of valuation of a property and identify the fiscal rules applicable. We have also concluded that what appraiser really undertakes in an appraisal assignment is the appraisal of the interest and/or dis-interest in the property and not the property itself. This emphasizes the need of appraiser acquiring sufficient knowledge about the various aspects concerning the property and the factors that affect the value of such a property.
01.02 The valuation of shares in a company for fiscal purpose or otherwise would require thorough knowledge on the part of appraiser the following aspects:

1) The nature of company as an organization;
2) The various types of companies; and
3) The legal nature of shares.

The study of share which is a property right created by a statute would involve understanding of the basic features.

02 WHAT IS A COMPANY AND WHAT ARE DIFFERENT TYPES OF COMPANIES?

02.01 In his Book, "The Social Frame Work", Sir John R. Hicks commenting on the two main features of companies, limited liability and transferability, said:

"He states that the shareholders has the protection of limited liability; but otherwise he puts himself into the hands of his Directors just as the sleeping partner, puts himself into the hands of his associates. He gives over his property to the Directors and lets them manage it for him so that it depends on their ability and their diligents whether or not he gets a good return, or whether he loses it altogether. At first sight, it seems astonishing that shareholders

1. The Social Frame Work - by Sir John R. Hicks.
should be found who will have such confidence in the Directors of public companies, people with whom they are most unlikely to have in close acquaintance. The explanation is partly found in another sequence of limited liability. Since a shareholder can not lose more than he has put in, whatever happens to the company in which he is invested, he will be in a safer position if he has small holdings of shares in a number of different companies than he has all his eggs in one basket. This sleeping partner could not do without adding to his risk, but it is the common practice of the modern capitalist.

02.02 Another way in which shareholders in a public limited company is protected, is by the facility with which he can dispose off his shares whenever he desires. Shares in a private company can not be sold except with the consent of the Directors of the Company, but shares in public companies can usually be bought and sold quite freely, without the companies' official being consulted in any way. In order to facilitate such transactions, there is a body of dealers, who are organized in the stock exchange. The ability to sell its shares on the stock exchange, does not indeed safeguard the shareholders against
the loss; if he gets bad news about the company and so wants to dispose off his shares, the chances are that other people will have heard of it as well, so that buyers will be hard to find except at the reduced price. But the pessimist does get a chance of withdrawing his fingers before they are burned too badly.

02.03 From the above, it is very clear that the two fundamental aspect of shares in a company that is limited liability and transferability of the shares in a company would enable the shareholders to venture out and invest in the shares of a company. What is this Company? A company may be defined as a form of organisation owned by large group of individuals called shareholders managed/launched by small number of individuals elected by the shareholders called "Board of Directors." The Company form of organization has benefit of common seal and perpetual succession. It is the legal person, separate from the person who own it. The word Company originally means, an association of a number of individuals formed for some common purpose. It involves two ideas. Firstly, the members of the association are so large that it could not be described as a
firm or a partnership and it permits the transfer of interest in the association subject to the formalities that are prescribed. It has also characteristic of what Cave J. Observed in Reshuffle Estate (22 q.b.d. 470)¹ "a corporation is a legal personal, just as large as an individual but with no physical existence."

03 DIFFERENT TYPES OF COMPANIES UNDER COMPANIES ACT

03.01 Under The Companies Act 1956, various types of Companies are:

1) Unlimited liability Companies where the liabilities of members is unlimited.

2) Companies limited by shares which are by far most numerous at the present time.

3) Companies limited by the guarantee where each member undertake to contribute in the event of Company being wound up, such amount not exceeding the specified amount, as may be required for the payment of debt of the company, etc.

1. Reshuffle Estate (22 q.b.d. 470).
03.02 The above would mean that the problem of valuation/appraisal of shares would arise mainly in cases where Company is limited by shares and as stated already there are numerous types of companies limited by shares at the present time. There are two varieties of each types of Companies, public company or a private limited company.

03.03 A public Company means a Company which is not a private limited company (sec. 3 - sub-section 3 clause - 14) and a private limited company is defined to mean a company which, by Articles, restricts, right to transfer its shares, if any; limits the number of its members to 50 (FIFTY) not including (i) persons who are in the employment of the company, and (ii) persons who have been formerly in the employment of the Company, were the members of the company while in that employment and have continued to be the members after the employment ceases, and (iii) prohibits an invitation to the public to subscribe for any shares or debentures in the company. In case when two or more persons hold shares in a company jointly, they shall, for the purpose or calculating ceiling of 50 be treated as a single member (Section 3 clause - sub clause (iii)). As against these restri-
ctions a Private Company is entitled to other privileges in the sense that quite a few provisions of the Act which apply to Public companies do not apply to private limited companies. The principal advantage of private limited company, is that they are generally family concerns and its nature would enable such a company to secure more privacy into their affairs and at the same time to have liability of their members limited either by shares or by a guarantee.

03.04 From the point of view of the appraiser the first step in the process of appraising would be to note the type of the company whose shares are to be valued. It is the knowledge of the type of the company that would direct the appraiser to make the appropriate enquiries. For example, if shares to be appraised, are shares of the public limited companies, the information would enable the appraiser to conclude that the restrictions of transfer-ability would be different than that of the private limited company. Thus the first step in an appraisal process would be to know the type of the company in which the shares are to be appraised.
03.05 After understanding the type of the company, the appraiser should do well to understand the other aspect of the nature of shares. This could be conceptional and legal.

04 DEFINITION OF SHARES

04.01 The definition of share in The Companies Act 1956 do not really give a satisfactory exposition of what a share really is. The definition of share in Section 2 (46) states that "Share means a share in capital of a company, and include stock except where a distinction between the stock and share is expressed or implied." Section 82 of The Companies Act, 1956, states that the share or other interest of any member in a company, shall be immovable property transferable in the manner provided by the Articles of the company. But, the term 'share' is defined differently in the course of judicial pronouncement. A share has been defined as an interest of the share-holder in the company which is measurable by a sum of money and is made up of various rights conferred on its holder by the Articles of the company which constitute a contract between him and the company, or alternatively also as the interest of the shareholder in the company measured by a sum
of money, for the liability in the first place, and of interest in the second constituting the series of mutual consents entered into by all the shareholders inter se.¹

05 INTEREST OF SHAREHOLDER - NATURE OF SHARE

05.01 Two basic interests - Dividend and Return on Capital:

The interest of the shareholder as specified by the Memorandum and Articles of Association of the company and the statute governing the affairs of the company relates to the nominal amount of a share which a person holds in a company and represents that portion of the Subscribed Capital of the company which, until contributed, is shareholder's liability in respect of that share, and which, when contributed, is the proprietary interest which belongs to him as the holder of that share. The share confers on the holder, a right to participate in the profits made by the company while it is a going concern and in the assets of the company, when it is wound up.

05.02 Share - A creature of Statute

05.02.01 Incorporeal in nature, a share is a creature of the statute, the property or interest therein being

¹. Borland's Trustee V. Steel Bros. Co. Ltd. (1961) 1 Ch. 279.
governed by the statute itself or the rules and regulations made thereunder. The rights and obligations created by the statute or under the statutory instruments or powers also define their extent, scope, boundaries and incidents. If the shareholder is entitled to participate in the dividends to be declared by the company or to vote at or to participate in the meetings of the company it is because the statute gives him the right to do so. If he is entitled to transfer the share in the company along with the rights attached thereto to some one else of his choice, it is because the statute empowers him to do so. The statute which confers upon him all these rights also lays down the limits within which he can exercise the same. The statute also prescribes the conditions precedent to the exercise of that power.

05.03 Nature of a Share:

Proprietary character of share:

05.03.01 A share in a company is the expression of a proprietary relationship: the shareholder is the proportionate owner of the company but he does not own the company's assets which belong to the company as a separate and independent legal entity.
06 RIGHTS AND DUTIES CARRIED BY A SHARE

06.01 Although the rights and duties carried by a share are, on principle, indivisible, it is often convenient to regard a share as a bundle of several rights and liabilities and to consider these separately:

The principal rights which a share may carry are -

1) the right to dividend, if, while the company is a going concern, when validly declared;

2) the right to vote at the meetings of members; and

3) the right, in the winding up of the company, after the payment of the debts to receive a proportionate part of the capital or otherwise to participate in the distribution of assets of the company.

06.02 The principal duty of a shareholder, as far as the company is concerned, is -
to pay what is due on the share, i.e., disregarding any premium or discount, the nominal amount of the shares.

06.03 The moneys payable on the share have to be paid by the share-holder when a call for payment is made upon him by the company, or at the dates fixed for payment by the terms of issue. In the case of a public company at least five percent of the nominal value of the share and the whole premium must be paid up before the share is allotted.

07 OTHER RIGHTS AND DUTIES OF SHARE HOLDERS

07.01 Apart from these principal rights and duties, others, of ancillary character are carried by a share, e.g. the following rights of the shareholder:

a) to receive notice of general meetings unless the Articles otherwise provide; (Sec. 171);

b) Right to appoint a proxy, who need not be a member;

c) to receive a copy of every Balance Sheet (and of the documents annexed thereto) which is to be laid before the general meeting (Sec. 219);
d) to receive a copy of the Memorandum and the Articles of Association of the company (Sec. 39, 1-a);

e) to inspect and obtain copies of the minutes of General Meetings (Sec. 196);

f) to inspect copies of Directors' service contracts (Sec. 30);

g) to inspect the various Registers to be maintained by the company;

h) to subscribe for new shares of the same class unless the directors are duly authorised to the contrary (sec. 81).

07.02 Apart from those principal and ancillary rights which a share carries, the shareholder is further entitled to the numerous corporate and individual membership rights which the constitution of the company or the Acts themselves give him; examples of these rights are:

a) to petition the court for the winding up of the company (sec. 439);
b) to request an investigation into the affairs of the company (sec. 235);
c) to petition for the remedy available in case of operation and mismanagement or prejudicial conduct (sec. 358)

07.03 Examples of ancillary liabilities of the share-holder are:

a) in the winding up of the company, to be placed, upon certain conditions, as a past member on List B of the contributories;
b) to be personally and severally liable, in the conditions for certain debts of the company, if the number of shareholders is reduced below the minimum;
c) to repay any dividend received which he knew or ought to have known was made in contravention of the Rules as to distributable profits.

07.04 To sum up: "The holding of a share in a company limited by shares generally carries the right to receive a proportion of the profits of the company..."
called dividend and of its assets in the winding up, and all other benefits of membership, combined with an obligation to contribute to its liabilities, all measured by a certain sum of money which is the nominal value of the share, and all subject to the Memorandum or Articles of the company.¹

08 SHARE IS MOVABLE PROPERTY

08.01 A share is a movable property both under the Companies Act 1956² and the Indian Sale of Goods Act, 1930.³ But a share is not a movable goods like furniture, wearing apparel, a bag of rice or similar natural goods. It is only so by definition in the statute. Normally, any goods of a natural description can be acquired, transferred or disposed of without any specific formalities being required to be followed. The acquisition, transfer or disposal of shares, is, however, governed by the statute and the rules made thereunder and the Articles of the company. Its transfer in any other manner is not permissible. The Articles of a company invariably provide the manner in which the share transfers are to be effected.

1. See Farwel J. in Borland's Trustee v. Steel Bros. & Co. (1901) 1 Ch. 279, 288 and Romer L.J. in Re Paulin (Sir William Thomas) (1925) 1 K.B. 26, 56, 57.
2. Section 82.
3. Section 2 (7).
In case the company's Articles are silent, the provisions contained in Table 'A' would apply.

08.02 TRANSFER OF PROPERTY ACT APPLIES

The property in shares is of a peculiar nature, the same being severable as between the right to acquire the shares and the shares when acquired. Thus, a mere title to get one's name put on the register of Members may also constitute property within the meaning of section 6 of the Transfer of Property Act, 1982. This is distinct from the full property in the shares of a company which is acquired after the name of the person entitled is put on the Register of Members. The delivery of share certificate is something which the person having title to the shares can enforce against the company. Even the act of subscribing to the Memorandum whereby certain shares are agreed to be taken confers a right of title to acquire the shares and the subscribers remain liable to pay for them.

1. Schedule 1 to the Companies Act, 1956.
INCIDENTAL RIGHTS ARE NOT PROPERTY

ARTICLE 19 OF THE CONSTITUTION, WHETHER APPLIES

Although share is by itself property, the rights, privileges, or other benefits attached to the holding of shares cannot be regarded as property at least within the meaning of article 19 of the Constitution of India. Thus, the right to elect directors, right to have directors by passing resolutions and the right to present a petition for the winding up of company are certainly privileges incidental to the ownership of shares which itself is property, but it cannot be said that these rights by themselves and apart from the shares, are property within the meaning of article 19 of the Constitution, for that article regards only that as property which can by itself be acquired, disposed or taken possession of.  

SITUS OF SHARES

Registered Office is a place where shares can be effectively dealt with:

10.01.01 Since shares are property, an interesting question that is required to be resolved is with regard to the situs or situation of this property. The Supreme Court has held that the situs of shares which are movable, is normally the place where they can be effectively dealt with. There are series of decisions both in England and U.S.A. which lay down the test which must be applied to determine the local situation of shares of a joint stock company when that fact has to be determined, in order to decide as to the liability to or immunity from local taxation. This test has been epitomised in the single question as to where the shares will be effectively dealt with. It is the answer to this question which has led the courts in India and outside to hold that the situation of shares must be the Registered Office of the company. The situs of shares happens to be an important point to be taken into account while dealing with transmission of shares and also for deciding the question of stamp duty levy.

11 TYPES OF SHARES

11.01 Prima facie the rights carried by the shares
rank pari passu, i.e. the shareholders participate in the benefits of membership equally. It is only when a company divides its shares capital into different classes with different rights attached to them that the prima facie presumption of equality of shares may be displaced.

11.02 Speaking generally, a separate class of shares is constituted when the principal rights carried by the shares differ from those carried by other shares; e.g. some shares carry preferential or deferred rights as to dividend or capital, or more votes than other shares. But differentiation between other rights may suffice to create a different class of shares, e.g. differences as to freedom of transferability, or redeemability under The Companies Act, 1956.

11.03 Where a company has divided its capital into different classes, these classes have usually distinguishing descriptions and a company is at liberty to attach to them such descriptions as appear appropriate. Often the classes of shares are described as "Ordinary Shares," "Preference Shares," "Employees' Shares" and "Deferred Shares." Sometimes,

however, a company may use a more complicated terminol- 
yogy and e.g. refer to them as "First Preference 
Shares", "Ordinary Preference Shares", etc. The law 
does not attach a rigid, uniformly applicable meaning 
to these descriptions. The rights carried by the 
shares have, in every case, to be gathered from the 
terms of issue and normally reproduce the relevant 
provisions of the Memorandum and Articles.

11.04 EQUITY AND PREFERENCE

Section 85 of The Companies Act 1956 defines 
the different types of shares a company can issue. 
Sub-section (2) of this section states that all 
share capital which is not Preference Share capital 
is Equity Share capital. Thus, Equity Shares have 
been defined negatively as those shares which are 
not Preference Shares.

11.05 ORDINARY SHARES

11.05.01 Ordinary shares, in financial terminology 
sometimes referred to as the "equity" or "risk" 
capital, normally confer on their holders the residue 
rights of the company which have not been con-
ferred on other classes. The ordinary shares usually 
carry the main financial risk if the company is 
unsuccessful, but they carry the greatest prospects 
of financial reward if the venture of the company
is successful. Indeed, subject to the rights of other classes (which are normally, though not always, limited in extent) the rights of the ordinary shares are unlimited as their responsibilities are; after dealing with the distributable profits as required by the Articles, e.g. after providing for any dividend which is preferentially conferred upon other classes of shares, the whole of the profits distributable as dividend can be made available to them (unless preference shareholders or others have participating rights). If as is frequently the case the ordinary shareholders constitute the only class of shares carrying votes, they can have the whole of these available profits distributed to themselves by way of dividend, if they so wish, or can have them capitalised and distributed as bonus shares or debentures.

11.04.02 This description of the position of ordinary shares (as against other classes) may, however, be departed from as where ordinary share capital is repaid before the whole of the preference share capital.

11.05.03 In a winding up the ordinary shares are entitled to the entire surplus of assets remaining
after payment all the liabilities including preferential liabilities of the company and after the return of the capital of all classes of shares, unless preference shares are given the right to participate in the distribution of those surplus assets.

12 NON-VOTING SHARES

12.01.01 It is permissible to issue Ordinary Shares not carrying voting rights. Such shares are sometimes referred to as "A" shares. This practice has proved to be controversial and is intended, in a time of inflationary tendencies, to give investors an opportunity of acquiring "equity capital", in the sense in which the term is used earlier, without exercising control. The practice is not, however, widespread and is disapproved by The Stock Exchange. Non-voting ordinary shares are a separate class of shares. In India, recently, it has been reported that Central Government is thinking to permit issue of this types of shares specially for the purpose of stimulating capital market. It has been reported that the

thinking is to permit issue of this type of shares to non-resident Indians to be acquired out of their Foreign Exchange funds. This would obviate the threat of NRI take over bids while keeping flow of NRI funds.

13 PREFERENCE SHARES

13.01.01 One of the most important classes of shares which a company may issue is Preference Shares.

14 REDEEMABLE SHARES

14.01 Power to issue redeemable shares:

14.01.01 Section 86 of the 1956 Act authorises both private and public companies to issue redeemable shares i.e. those specifically redeemable under the terms of their issue.

14.01.02 The power to issue redeemable shares must be contained in the Articles but, subject to that, such shares may be issued as redeemable either at a set date or event, or at the option either of the company or the shareholders. Now it is not possible to issue non-redeemable preference shares reason being; Sec. 80A of The Companies Act 1956 provides
for compulsory redemption within 10 years of issue.

14.03 PREFERENTIAL RIGHTS

14.03.01 As their name implies, preference shares carry some preferential rights in relation to other classes of shares, particularly in relation to the ordinary shares. These preferential rights are of great variety but refer normally to one or two of the principal rights carried by shares, viz. the right to dividend and the right, on winding up, to receive a proportionate part of the capital or otherwise to participate in the distribution of assets of the company.

14.03.02 There may be more than one class of preference share, e.g. first preference and second preference shares, as well as ordinary shares; or there may be preference shares, ordinary shares and deferred shares, in which case the ordinary shares may, in fact, themselves be preferential in relation to the deferred shares. The name of the shares is not itself decisive: what matters is their relation to the other classes of shares of the company.

14.04 Preferential, Cumulative and Participating rights:

14.04.01 In considering the rights of holders of preference shares four questions arise:

1) As to preferential rights: the shares will invariably carry preferential rights as to capital?

2) As to cumulative rights: Are the rights of the preference shares cumulative as to dividend? This is the case where the shareholders are entitled, if the company has failed to declare the preference dividend in any one year, to claim the missed dividend in the subsequent year and so forth, so that an accumulation of preference dividend takes place. On the other hand, they are non-cumulative where it is intended that the shareholders, if not receiving preference dividend in any one year, shall not be entitled to the missed dividend in any subsequent years. The question whether the preference shareholders are entitled to cumulative dividend arises only during
the active life of the company, but such accumulation may further raise a problem in the winding up, viz. if there are so-called arrears of cumulative preference dividend outstanding at the commencement of winding up, can they be recovered in the winding-up proceedings?

3) As to participating rights: The question here is whether the preference shares carry the right to participate in the distribution of dividend in excess and beyond their right to preferential - and possibly cumulative-dividend, and, further, whether they are entitled to participate in the distribution of the surplus assets of the company remaining after the payment of the company's liabilities and the return of the capital to the shareholders.

4) As to frustration of those rights: In recent years it has become necessary to ask whether all or any of these rights may be frustrated by a reduction of capital under section 100 of The Companies Act, 1956.
5) As to voting right whether preferential shareholders have voting right in the event of non-payment of the dividends?

The Companies Act provides for the right to vote in case of the preferential shareholders of the public limited companies, if dividend is, in case of cumulative preference share, is unpaid for period not less than two years preceding that of commencement of meeting and in case of non-cumulative preference share of a period not less than two years or three years out of the six previous years.

15.01 LEGAL NATURE OF SHARE

15.01.01 The question as to the legal nature of the share received judicial attention from Farwell J. in Borland's Trustee v. Steel Brothers and Co. Ltd. In the said case, Farwell J. said:

"A share is the interest of a shareholder in the company measured by a sum of money, for the purpose of liability in the first

place, and of interest in the second, but also consisting of a series of mutual con-
venants entered into by all the share-
holders inter se in accordance with
Section 16 of the Companies Act, 1862*. The contract contained in the articles of asso-
ciation is one of the original incidents of the share. A share is not a sum of money settled in the way suggested, but it is an interest measured by a sum of money and made up of various rights contained in the con-
tract, including the right of a sum of money of a more or less amount .... These articles
are nothing more or less than a personal contract between Mr. Borland and the other shareholders in the company under the 16th Section of the Companies Act, 1862.
Mr. Borland was one of the original share-
holders, and he and his trustee in bankruptcy are bound by his own contract."

The judge also observed that each of the other shareholders who came in afterwards executed a deed of transfer which, in the terms in which it was executed,

* of England
made him liable to all the provisions of the original Articles, Farwell J. continued:

"These shares can have no value ascertainable by any ordinary rules, because, having held, as I do, that the restrictive clauses are good, it is impossible to find a market value. There is no quotation. It is impossible, therefore, for any one to arrive at any actual figure, as to which it may be said it is clear that is the value...

Having regard to the fluctuation in profits that has occurred, it is impossible to say the value can be ascertained upon a 10 or 20 percent basis - that must be illusory...

What this case makes abundantly clear is that the real essence of a share consists in the series of mutual covenants entered into by all the shareholders.

16. FINANCIAL AND LEGAL ASPECTS OF PREFERENCE SHARES.

16.01.01 It is necessary to note the different approach to preference shares by the business and the lawyer.
16.01.02 From the financial point of view a difference is drawn between "risk capital" sometimes called "the equity of the company", and "loan capital". Preference shares which do not carry participating rights are not regarded in financial circles as representing part of the equity of a company.

16.01.03 From the legal point of view preference shares, whether carrying participating rights or not, are undoubtedly shares and are treated as such; in particular, when it is intended to pay them off, the capital reduction procedure, has to be complied with, and in the winding up they rank as shares, i.e. a distribution on them can only take place after the creditors of the company have been satisfied.

16.01.04 In more recent years the financial and legal points of view have drawn closer together: first, the Acts themselves have adopted the test of the "equity share capital" when defining the holding company in relation to its subsidiaries; the statutory definition of "Equity Share Capital" includes participating preference shares but excludes non-participating preference shares. Secondly, important dicta from the Bench, in particular from Lord Simonds and

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1. According to the guidance issued by controller of Capital issue preference shares which are redeemable beyond 12 years are to be treated as Equity Shares for the purpose of determining both equity ratio.
Sir Raymond Evershed have recognised that the position of the preference shareholder has become more approximated to that of the debenture holder than was the case some 60 years ago, and that recognition is reflected in recent decisions. However, the fundamental legal concept that a preference share is a share has never been qualified by the courts or by statute and obviously cannot be qualified.

17.01 Deferred Shares

17.01.02 The name "Deferred Shares" is derived from the fact that their rights are usually made subject to the rights of other shares. The commonest rights attached to shares of this nature are a right to a certain proportion of surplus profits in each year after payment of a dividend on any shares ranking before them, and, in the event of the company being wound up, a right to the whole or a certain proportion of surplus assets after repaying the capital paid up on any shares ranking before them.

18.01 Founders' Shares

18.01.01 Founders' shares are now practically obsolete. The name 'founders' shares was given to them because they were usually taken by the persons...
founding the company in part payment of the consideration payable for the property sold by them to the company. The rights attached to such shares were usually similar to those of deferred shares, and in the case of prosperous companies such shares were often of great value.

19.01 EMPLOYERS' SHARES

19.01.01 Many companies have in recent years issued shares to their employees under one of many varying employee share schemes. Their importance has been increased by recent tax incentives afforded to certain types of scheme. The shares issued under different schemes have few common characteristics and may or may not constitute a separate class of shares from other Ordinary or preferred shares. Some restrictions on transfer in the early years of ownership are common and frequently voting rights are restricted.

19.01.02 The Employees' share scheme may be defined as any scheme for encouraging or facilitating the holding of shares or debentures in company by or for the benefit of the company's bonafide employees or former employees or those of the company's group, or their spouses, widows, widowers or step-children. The
issue under such scheme are regarded generally as being domestic concerns of the company making them and thus not an issue to the public either for the purpose of the private company classification or for prospects liability.¹

20.01 SHARE TRANSFER

20.01.01 As discussed shares are property transferable in the same way as any other property movable or immovable. Section 6 of the Transfer of Property Act, 1982, provides that property of any kind can be transferred as provided by the act or except as otherwise provided by the governing statute. Thus, in the absence of any statutory restriction, shares can be transferred or sold in the same manner as any other goods. Like goods, shares can also be made the subject matter of an agreement for sale. An enforceable agreement to convey the property in shares does not, however, itself amount to transfer of shares which has to be separately executed. Thus, both the purchaser and the seller may bind themselves by an agreement for the sale of shares which are yet to come into existence. An agreement by the subscribers

¹ C. Kuppih Chetty v. P. Saraswathi Ammal (1941) 11 comp. cas. 334.
to the memorandum may, therefore, be enforced. Similarly, the promoters of a company may enter into an agreement for issue of shares by prospectus in respect of a Company which is yet to commence its business, appoint directors and issue shares. Again, like goods, shares are also subject to unpaid seller's lien.

20.02 OWNER'S INHERENT RIGHT TO TRANSFER THE PROPERTY IN SHARES:

20.02.01 The right to transfer the property in shares is an inherent right of the owner of the property comprised in the shares, so that it is inconceivable that any absolute fetters can be imposed on the owner's right of disposition over the shares. Thus, even the shareholder of a private limited company which is required by law to impose restrictions on transferability of shares cannot be denied the ultimate right of transferring the shares. Law only permits the private limited company to impose certain requirements or lay down certain limitations subject to which the transfer of shares can be accepted by the company.

20.03 RESTRICTIONS ON TRANSFERABILITY NOT PECULIAR TO PRIVATE COMPANY ONLY:

20.03.01 On the otherhand, although public limited
company cannot impose restrictions on the transferability of shares, it would be a mistake to assume that the directors of a public limited company cannot, under any circumstances, refuse to accept the transfer of shares. As a matter of fact, the directors of a company would be perfectly within their right to refuse to the transfer of shares if the purported transfer is sought to be made by the transferor or transferee, with any malafide intention, for a vexatious purpose or with designs likely to act prejudicially against the interest of the company.

21.01.01 Cross holdings not permitted:

Section 42 of The Companies Act 1956 prohibits the transfer or allotment of shares to a subsidiary unless such acquisition by a transfer is in the capacity of a legal representative or trustee. The prohibition in this section does not, however, extend to the holding of shares by the subsidiary in holding the company before its becoming the subsidiary.

21.01.02 Section 77 of The Companies Act 1956,
prohibits the purchase by the company of its own shares or its holding company's shares, the only way in which this can be effected is by going for reduction of capital in pursuance of an order of court.

21.01.03 Section 402 of The Companies Act 1956 empowers the court to pass an order limiting the transfer of shares of a member either to the other members of the company or to the company itself. Similar restrictions on the transferability of shares may come into operation in the course of petition under Section 395 of The Companies Act 1956 involving any scheme or arrangement.

21.01.04 Transfer of shares of a company under liquidation:

Section 536 of The Companies Act 1956 prevents the transfer of shares of a company under voluntary winding up if such transfer takes place without the sanction of the liquidator. Similarly, in the case of a company which is being wound up by the Court or under its supervision, any transfer of shares is void without prior consent granted by the Court.¹

¹ V. Rajagopal v. Salem Provident Society Ltd. (Under liquidation) (1963) 33 Cas. 435.
22.01 STATUTORY RESTRICTIONS UNDER OTHER ACTS ON TRANSFER OF SHARES

22.01.01 Court's General Power to Restrict Transfer:

Statutory restrictions on the transfer of shares are not confined merely to the provisions of the Companies Act. The Code of Civil Procedure, 1908\(^1\) empowers the court to issue an injunction on a company, which may, among other things, restrain the company from accepting the registration of any transfer of shares. A transfer of partly paid shares by a member to a pauper constitutes a fraud on the company and is not only void but is also illegal.

22.01.02 Restriction under MRTP Act:

The Monopolies and Restrictive Trade Practices Act, 1969\(^2\), confers powers on the Central Government, while ordering division of an undertaking, to make any order regulating the transfer of property (which includes shares) as would be necessary to give effect to the division of the undertaking.

22.01.03 Restriction under I(D.R) Act:

Once an undertaking has been taken over by

1. Order XXXIX, Rule 5.
2. Section 27 (3).
the Central Government under the Industries (Development & Regulation) Act, 1951, any further transfer of shares may not be allowed to take place without the previous approval of the Central Government.

22.01.04 FERA Restrictions:

There are also restrictions under the Foreign Exchange Regulation Act, 1973, on the transfer of shares to/by a non-resident. Generally every transfer of shares in an Indian company by non-resident Indian or Foreign national would require the approval of the Reserve Bank of India. The transferer and the transferee are under obligation to obtain the approval from the Reserve Bank of India. Further there is an obligation on the company to see that the approval of the Reserve Bank of India has been obtained before accepting the transfer of shares.

22.01.05 Restriction under the Estate Duty Act:

Section 84 (1) of the Estate Duty Act, 1953, prohibits the company from registering the transfer of shares standing in the name of the deceased unless the transferee has acquired such shares for valuable consideration and a certificate from the Controller of Estate Duty is produced before
the company to the effect that the estate duty in respect of such shares has been paid or will be paid or that nothing is due, as the case may be. This restriction does not, however, extend to transmission of shares by operation of law. Therefore, the provisions of section 84(1) do not apply to cases where the heirs or the survivors of two or more joint holders apply for registration in their names of the shares held by the deceased.

22.01.06 Income-tax restrictions:

Rule 26 of the Second Schedule to the Income-tax Act, 1961, permits the attachment of the shares of a company and for this purpose a prohibiting order may be issued by the Tax Recovery Officer in Form No. ITCP 4 prescribed under the Income-tax (Certificate Proceedings) Rules, 1962, restraining the person in whose name the share may be standing; from transferring the shares or receiving the dividends thereon.

22.01.07 Restriction under the Provincial Insolvency Act:

The Provincial Insolvency Act, 1920 (section 54) also specifically declares any transfer of
property by the insolvent void against the receiver.

22.01.08 Restriction under the Securities Contracts (Regulation) Act:

The Securities Contracts (Regulation) Act, 1956, also imposes certain restrictions on sale and purchase of listed shares through members of stock exchange and brokers when the Central Government issues any notification in this behalf.

02.01.09 Restrictions under laws dealing with payment of stamp duty, lunacy, minority and insolvency:

There are also provisions in similar other statutes which will have to be complied with before any transfer can be validly effected. A transfer of shares which does not comply with the provisions of Indian Stamps Act, 1899, is not valid. Also the transfer of partly-paid shares to a minor is invalid in law. Law also prohibits the transfer of shares belonging to a lunatic or insolvent unless the transfer is effected by natural or legal guardian in the case of the lunatic and by the receiver in the case of insolvent.

23.01 SHARE TRANSFER RESTRICTIONS ARISING OUT OF COVENANTS.

23.01.01 Transfer to and by nominees:

If the statute otherwise permits, the
shareholder of a company can voluntarily submit, under a covenant, to abide by certain restrictions governing the transferability of shares. Thus, a nominee holding shares on behalf of the holding company or the nominees of the President or Governor may be bound to abide by the restrictions that the shares held by them can be transferred only to such persons as named by the nominator. In such cases, the shares are held by the person nominating though they may be formally registered in the name of the nominees. Sub-section (3) (b) of Section 4 of the Companies Act 1956 makes it clear that any shares held by any person as nominee of a company shall be treated as held by the company itself. Similarly, in the case of Government Companies, the shares held by Government officials as nominees of the President or Governor, as the case may be, are not freely transferable and can be transferred only as the nominator directs.

23.01.02 Restrictions imposed by Articles are but restrictions by covenants:

In the case of private limited companies, members submit themselves to a mutual covenant called the 'Articles of Association' whereby they agree voluntarily to abide by certain restrictions relating
to transferability of shares. As a matter of fact, the existence of such a mutually binding covenant follows from the statute itself. Section 3(1)(iii) of The Companies Act, 1956 stipulates that a private limited company may, by its Articles, restrict the right of transfer of its shares. Apart from recognising the basic functioning of a private limited company as a closely-held one through this provision, restriction also ensures that the power of free transferability of shares, if allowed to a member of a private limited company, does not lead to a situation where the number of members of a company may exceed the limit of fifty.

23.01.03 Restriction through covenants may extend to public limited companies as well:

It would be erroneous to think that restrictions arising out of mutual covenants among members are peculiar to a private limited company. Although not specifically sanctioned by the statute, certain restrictions are nevertheless permissible as forming part of the Articles of Association of a public limited company as well. Thus, the articles of a public limited company may provide that certain conditions must be fulfilled before a member is allowed to transfer
partly-paid shares, certain transfer fees have to be paid for transferring the holdings in splits below the minimum prescribed lot or even provide generally that the company would not permit transfers in circumstances prejudicial to the interests of the company. In the latter case, however, the restriction is justifiable. In case the public limited company goes for listing of shares with a recognised stock exchange, the latter invariably insist on the removal of these restrictions, except the last one, and may also additionally impose certain restrictions by making suitable changes in the covenant itself, namely, Articles of Association. Thus the stock exchange listing requirements may include a condition that not only any further issue of shares should be offered to the existing shareholders not withstanding the permissibility to the contrary vide section 81 of the Companies Act, but the existing shareholders must offer their shares to the public and not the persons of their choice, at the time of issue of prospectus. Similarly, an Indian company having non-resident interest exceeding 40% and being under compulsion of the Reserve Bank of India direction to dilute its equity may have to approach RBI for permission that their existing shares shall be offered to the Indian public.
23.01.04 Between the pledger and the pledgee:

Any holder of shares can also bind himself while pledging of his shares, to the effect that until the charge is satisfied, he shall not transfer his shares.

23.01.05 Restrictions enforced through scheme of arrangement:

Shareholders of a company may also agree to transfer their shares in exchange for their shares of another company in a scheme of reconstruction or amalgamation and once the scheme is sanctioned by the court it would no longer be within the powers of the shareholders to transfer shares in any other manner.

24 Having obtained complete background as to concept and legal aspect of nature of shares we shall now proceed to fiscal valuation of shares. The first step would be to ascertain the occasions for valuation/appraisal assignments. The next would be to lay down the principles which shall have conceptual (Accounting principles), Statute based (legal provisions contained in the Acts and Rule framed thereunder) and case law base (Interpretation of conceptual and the
legal provisions by courts while dealing with various cases). Before we do so, let us identify certain basic features or constraints in appraisal assignment for fiscal purpose.