Reconstruction of Companies

Reconstruction :- The need for reconstruction arises when a company has accumulated losses or when a company finds itself overcapitalized which means either that the value placed on assets is too much as compared to their earning capacity or that their profits as a whole are insufficient to pay a proper dividend.

Types of Reconstruction: - Reconstruction is of two types

External reconstruction and Internal reconstruction.

1. External reconstruction: - Under external reconstruction the ailing company is liquidated and a new company (consisting substantially the same shareholders) is formed to acquire the business of the old company. An attempt is made that the newly started company has a sound financial structure and a good set of assets and liabilities recorded in the books of the transferee company at their fair values.

- **Legal position**: - Section 494 of the Companies Act permits the liquidator of a company to transfer the whole or any part of the company's business or property to another company and receive from the transferee company (by way of compensation or part compensation) shares etc. in the transferee company fro distribution among the shareholders of the company under liquidation. The liquidator must obtain the sanction of the company by a special resolution. Any sale or arrangement in pursuance of this section is binding on the members of the transferor company.
  But a share holder who has not voted for the special resolution may, within seven days of the resolution, serve a notice on the liquidator expressing his dissent and requiring the liquidator either, (a) to abstain from carrying the resolution into effect or to purchase his interest at the price to be determined by agreement or arbitration.

Distinction between External reconstruction and Amalgamation

S No.	Basis	External Reconstruction	Amalgamation
1.	**No. of existing companies**	In external reconstruction only one existing company is involved	In amalgamation, there are at least two existing companies which amalgamate.
2.	**New Company**	In external reconstruction a new company is certainly formed	In amalgamation a new company is formed or one of the existing companies may take over the other amalgamating company and no new company may be formed.
3.	**Objective**	The objective is to reorganize the financial structure of the company.	The objective is to cut the competition

2. Internal Reconstruction: - Internal reconstruction is undertaken by companies that have surplus capital or companies whose capital has been eroded by trading losses.

Under this scheme the capital of company is reduced. Section 100, of Companies Act 1956, deals with reduction of capital. According to it reduction of capital may take the following forms: -

(a). Extinguishing or reducing the liability on any of the shares in respect of the unpaid amount.

(b). Cancelling any paid up shares capital (writing off) which is lost or unrepresented by available assets together with or without extinguishing or reducing liability on shares.

(c). Paying off capital (already paid up) which is in excess of needs of the company (again together with or without extinguishing or reducing liability on shares).

Cancellation of Paid up Share capital Which is Lost: - A company intending to reduce the capital have following features:-

1. Heavy debit balance in the Profit & Loss A/c.
2. Unwritten off fictitious assets in the Balance Sheet such as Preliminary expenses; Underwriting commission; etc.
3. Existence of Goodwill in the Balance Sheet.
4. Over valued assets, because company due to losses charges inadequate depreciation.

General Provisions: - The Company wishing to reduce their capital need to comply with the following requirements as laid down in the Companies Act, 1956.

1. The capital reduction scheme must be confirmed by the Hon. Court.
2. The Articles of Association must provide for the reduction of capital.
3. A special resolution must be passed by the company.
4. If any creditor has any objection to the scheme of capital reduction, his outstanding amount should either be paid or secured as directed by the Hon. Court.

Notes: - Following point must be taken into consideration.

- Goodwill account appearing in the Balance Sheet is written off completely because a company which has been incurring losses can not be said to be enjoying any goodwill.
- When the losses are heavy Preference Shareholders may also made to make a sacrifice. To compensate them for their sacrifice to some extent, the rate of their dividend for the future may be increased, although as far as arrears of dividend are concerned they may be made to forgo them.
- **If the losses to write off are very heavy, even Trade Creditors and debenture holders may be persuaded to make a sacrifice. *In such case Capital Reduction Account is not opened it must be either Reorganisation Account or Reconstruction Account*.**
- Also when assets are revalued there may be appreciation in the value of a few assets for example usually there is an appreciation in the value of Land & Building Such an appreciation is also available for writing off losses. Similarly there may be capital profits like profits prior to incorporation which may also be used to write off losses under a scheme of reconstruction.
- The Hon. Court may direct the company to add the word "And Reduced" to its name for such period as it thinks fit. The Hon. Court may also requires the company to publish such statement, in the press, in regard to the reduction of capital, as the Hon. Court may think expedient, with a view to giving proper information to the public.