Unit – 2 (Internal Reconstruction of Company)

Internal reconstruction : **Internal reconstruction** can be defined as the reorganization of the **company**, without liquidating the existing **company** and forming a new one. In **internal reconstruction**, the capital of the **company** is reduced, and external liabilities such as debenture holders and creditors waive their claims by giving a discount.

Difference between internal reconstruction and external reconstruction of companies :

Basis	Internal Reconstruction	External Reconstruction
Meaning	Internal reconstruction refers to the method of corporate restructuring wherein existing company is not liquidated to form a new one.	External reconstruction is one in which the company undergoing reconstruction is liquidated to take over the business of existing company.
New company	No new company is formed.	New company is formed.
Use of specific terms in Balance sheet	Balance Sheet of the company contains "And Reduced".	No specific terms are used in the Balance sheet.
Capital reduction	Capital is reduced and the external liability holders waive their claims.	No reduction in the capital.
Approval of court	Approval of court is must.	No approval of court is required.
Transfer of Assets and Liabilities	No such transfer takes place.	Assets and liabilities of existing company are transferred to the new company.

Different forms/ methods of internal reconstruction :

Forms/ methods of internal reconstructions are :

1. Alteration of share capital : A company limited by shares can alter its share capital if it is authorized by its Articles to do so under section 94(1). Alteration of share capital may involves the following :
   a) Increase in share capital.
   b) Consolidation of shares of smaller denominations into shares of higher denomination.
   c) Sub division of shares into shares of smaller denomination.
   d) Conversion of shares into stock.

e) Cancellation of it unissued shares.

2. Reduction of share capital : Reduction of share capital means that the capital written off is used to eliminate the accumulated losses and to bring down the assets to their values. It is a process of by which the face value of shares is brought down to their intrinsic values and the net assets become representative of its paid up capital. When a company has been suffering losses continuously for any reason and a part of its capital is lost and is not represented by the available tangible assets, in such a situation , reduction of share capital is resorted to in order to cancel any paid up capital which is not represented by tangible assets.
3. Variation of shareholders right : Where a share capital of the company is divided into different classes of shares, the rights attached to the shares of any class may be varied with the consent in writing of the holders of not less than three-fourths of the issued shares of that class or by means of a special resolution passed at a separate meeting of the holders of the issued shares of that class,—

(a) if provision with respect to such variation is contained in the memorandum or articles of the company; or

(b) in the absence of any such provision in the memorandum or articles, if such variation is not prohibited by the terms of issue of the shares of that class:

4. Scheme of compromise/ Arrangement : The term compromise includes any amicable settlement of a matter in dispute between the company and its creditors or members by mutual concession.

The term arrangement includes reorganization of share capital of the company by the consolidation of shares of different classes or by the division of shares of different classes or by both these methods.

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Legal requirements for capital reduction : The following are the legal requirements for capital reduction :

1. Authorized by the Articles.
2. Ways of Reduction of share capital.
3. Passing of special resolution.

4. Tribunal’s order.
5. Filling the order with the registrar
6. Reduced to be added to the Balance sheet
7. Reasons for capital reduction.
8. Notice to be published
9. Effective date of capital reduction
10. Reduced figures in the subsequent Balance sheet
11. Amount of reduction in the Balance sheet for five years