



Accounting for the issue of Bonus Debentures

KEYWORDS

Bonus debentures, Bonus shares, deemed dividend, shareholders, dividend distribution tax.

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ABSTRACT *When companies accumulate large amounts of reserves and surplus over the years of operations, they are likely to reward their shareholders. The most popular form of rewarding shareholders is through issue of bonus shares. However, in the recent past, many Indian companies have adopted to the innovative instrument of bonus debenture to restructure reserves, manage cash and reward shareholders. The Indian Companies Act does not contain any specific provision regarding the issue of bonus debentures. These debentures are issued under Section 391 as scheme of 'arrangement'. The present article attempts to identify the accounting and tax implications of the issue of bonus debentures and elaborate how the issue of bonus debentures may be recorded in the Books of Accounts.*

Accounting for the Issue of Bonus Debentures

In the world of financial instruments, bonus debentures are a recent entry. Many Indian companies have used this innovative instrument to reward their shareholders in case it has accumulated large reserves and profits over the years of operation. These undistributed profits and reserves belong to the shareholders and therefore, a company may decide to set free some portion of these retained earnings and apply them in paying up:-

- i) whole or part of the issue price of partly paid up shares of the company.
- ii) in paying full the nominal value of new shares, issued to existing shareholders as bonus shares.
- iii) in paying the full the nominal value of new debentures issued to existing shareholders as bonus debentures.

The new shares issued as bonus may either be equity shares or preference shares. Preference shares are issued with a redemption date. Similarly, bonus debentures are issued free of cost to the shareholders with a coupon rate and a fixed maturity period after which they are redeemed. It needs to be mentioned here that the Indian Companies Act does not contain any specific provision regarding the issue of bonus debentures. It only provides for issue of bonus shares. Therefore, corporates have been issuing bonus debentures through a scheme of the 'arrangement' under Sections 391 to 394 of the Companies Act. As per Section 391, the term 'arrangement' is of very wide import and includes all modes of reorganizing the share capital. The Articles of Association of a company may also require alternation if it does not already contain provision for such issue.

Key features of Bonus Debentures.

The key features of bonus debentures issued under a scheme of arrangement are:-

- i) Bonus debentures are issued from free reserves i.e. distributable profits and reserves which are otherwise available to pay dividend.
- ii) Bonus Debentures have a face value and an interest rate.
- iii) These debentures are redeemed on maturity.
- iv) The issue of bonus debentures is considered as 'deemed dividend' under the Income Tax Act, 1961.

Accounting and Tax Implications of the Bonus Issue of Debentures

The above key features bring forward the following Accounting and Tax implications of the issue of bonus debentures.

1. Securities Premium Accounts and Capital Redemption Reserves cannot be utilized to issue bonus debentures. Only divisible profits can be used for their issue.
2. The issue of bonus debentures will reduce 'Reserves and Surplus' in the balance sheet and will increase the 'Non-Current Liabilities' or the debt capital in the balance sheet. As a result, the net worth of the company will reduce.
3. Interest on these debentures is paid regularly (usually annually) till the date of maturity.
4. The bonus debentures are redeemed on maturity causing outflow of cash.
5. Earning per share of the company does not change after the issue of bonus debentures as the number of shares and the amount of share capital do not change.
6. The whole bonus debenture issue amount is considered 'deemed dividend' under the Income Tax Act, 1961, and the issuing company is required to pay dividend distribution tax on it.
7. In subsequent years, interest on bonus debentures is a deductible expense from the income and thus reduces tax.
8. When the debenture is redeemed by the company or it is sold by the debenture holder in the open market, the debenture holder will not be taxed to the extent of the face value of the debentures, as the tax on the face value is already paid by the company as dividend distribution tax in the year of issue of bonus debentures. Only the appreciation earned is taxed as capital gains in the hands of a shareholder.

Accounting Treatment at the Time of Issue of Bonus Debentures: -

In the books of account, the issue of bonus debentures is recorded in the following manner.

1. **Transfer of distributable profits and reserves to Shareholders' Account:-** An amount representing the aggregate face value of debentures is transferred from the Surplus A/c and/or any other permissible account to the Equity Shareholders Account which is represented by the Merchant Banker. Merchant Banker is appointed by the Board of Directors to act on behalf of and as agent and trustee of the Members i.e. equity shareholders. This is required because the issue of bonus debentures is considered deemed dividend payable to the shareholders under the scheme of issuance of such debentures. The following journal entry is passed.

Surplus Account	-----		Dr		(or) any
other Permissible Reserve Account	-----		Dr		Dr

To Equity Shareholders Account

(Being the deemed dividend payable to the shareholders)

2. Payment to shareholders: - An amount equal to the face value of debentures is transferred from bank account to the Shareholders Account, the shareholders being represented by the Merchant Banker. Merchant Banker receives the aforesaid amount in an escrow account.

Equity Shareholders Account ----- Dr

To Bank Account

(Being payment of deemed dividend under the scheme of arrangement)

3. Appropriation of profits to pay dividend distribution tax: - An amount representing the dividend distribution tax payable on deemed dividend i.e. aggregate face value of bonus debentures is transferred from the Surplus A/c to Dividend Distribution Tax A/c.

Surplus Account -----
Dr

(or) Any Permissible Reserve Account ----- Dr

To Dividend Distribution A/c

(Being Dividend Distribution Tax payable on deemed dividend is appropriated from Surplus A/c or any other permissible A/c)

4. Payment of Dividend Distribution Tax: - An amount equal to the dividend distribution tax is transferred to Central Government Account.

Dividend Distribution Tax Account ----- Dr

To Bank Account

(Being payment of dividend distribution tax on the aggregate value of the Debentures as 'deemed dividend'.)

5. Investment of deemed dividend by the shareholders in the Debentures of the company: -

An amount equal to the aggregate face value of bonus debentures is received in the bank account from the shareholders A/c represented by the Merchant Banker.

Bank Account ----- Dr

To Equity Share holders Account

(Being payment received from the Merchant Banker for and on behalf of the shareholders towards investment of deemed dividend in the debentures of the company).

6. Issue of Debentures: - Bonus Debentures are issued by transferring the amount from shareholders A/c to Debentures A/c.

Equity Shareholders A/c ----- Dr.

To Debentures A/c

(being debentures issued as per the scheme of bonus debentures)

Illustration: -

On 22nd March, 2010, Britannia Industries Ltd., allotted 2,38,90,163 debentures of 170 each (for every equity share of 10 each) amounting to an aggregate value of 406.13 crores from the general reserve by way of distribution as bo-

nus to the members based on their equity holding on the record date i.e. March 9, 2010. The interest rate is 8.25% payable annually for three years after which these debentures are redeemable. The company remitted 69.02 crores as dividend distribution Tax. Pass the necessary journal entries required to issue the bonus debentures in the books of Britannia Industries Ltd. ⁽¹⁾

Solution :
Britannia Industries Ltd.

Journal

Date	Particulars	L.F	Debit	Credit
			₹Crores	₹Crores
22 nd March, 2010	General Reserve A/c Dr To Shareholders A/c (Being the deemed dividend equal to the face value of bonus debentures of ₹ 406.13 payable to shareholders)		406.13	406.13
	Shareholders A/c Dr To Bank A/c (Being deemed dividend paid to shareholders under the scheme of issue of bonus debentures)		406.13	406.13
	General Reserve A/c Dr To Dividend Distribution Tax A/c (Being dividend distribution tax of ₹ 69.02 payable on deemed dividend payment of ₹ 406.13 crores)		69.02	69.02
	Dividend Distribution Tax A/c Dr To Bank A/c (Being dividend distribution tax paid on deemed dividend)		69.02	69.02
	Bank A/c Dr To shareholders A/c (Being payment received from shareholders towards reinvestment of deemed dividend in bonus debentures)		406.13	406.13
	Shareholders A/c Dr To 8.25% Debentures A/c (Being bonus debentures issued to shareholders)		406.13	406.13

Bonus Debentures V/s Bonus Shares: - A Comparative Analysis

Both the issue of fully paid bonus shares and fully paid bonus debentures amount to capitalization of reserves and surpluses of the company. But from the point of view of accounting and tax, they are different from each other in many aspects.

(1) The issue of bonus debentures may be made only out of distributable profits. On the other hand, Companies Act expressly permits the issue of fully paid bonus shares out of two funds not otherwise available for dividend namely, Securities Premium Account and Capital Redemption Reserve Account.

(1) www.britannia.co.in/

(2) The issue of bonus debentures is considered as 'deemed dividend' under the Income Tax Act, 1961, and therefore, a company issuing such debentures is required to pay dividend distribution tax on it. No such tax is payable at the time of issue of bonus shares.

- (3) Bonus shares increase the number of shares and hence, the share capital of the company which dilutes the Earnings Per Share of the Company. This never occurs in case of bonus debentures issue as debentures increase the debt in the capital structure keeping number of shares and share capital intact.
- (4) Interest on bonus debentures is payable regularly till their maturity. Interest on debentures is a tax deductible expense. However, dividend on bonus shares is an appropriation of profit so the company gets no tax benefit.

- (5) No cash outflow occurs on the capitalization of profits into bonus shares. However, bonus debentures are redeemed on maturity, leading to substantial cash outflow.

It is clear that both bonus shares and bonus debentures have their pluses and minuses. A company, which is cash rich and has low debt-equity ratio, may prefer bonus debentures as it won't enhance the number of issued shares diluting the EPS of the company.

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