

What are Bonus Debentures?

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Bonus Debentures were first issued by Hindustan Lever Ltd. way back in 2001, and since then only six other companies have issued bonus debentures, the latest being NTPC. What are these instruments?

The Board of Directors of National Thermal Power Corporation (NTPC) Ltd. at its meeting held on December 23, 2014, has approved a Scheme of Arrangement for the issuance of secured fully paid-up bonus debentures of face value of Rs12.50 each against every equity share of Rs10. In a first by a Public Sector Undertaking, NTPC has proposed to reward its shareholders through an innovative way of issuing bonus debentures. However, this innovative reward is seldom used by Indian companies. Bonus Debentures were first proposed to be issued by Hindustan Lever Ltd. way back in 2001,

and since then only six other companies have issued bonus debentures. What are bonus debentures?

As the name suggests, a bonus debenture denotes a debenture issued as a bonus to the eligible shareholders, that will entail a certain interest payment on periodical basis and will be redeemable after a fixed duration as may be decided by the company. Accordingly, an issue of bonus debentures turns accumulated free reserves into debt for the company.

Bonus Debentures v/s Dividend: While approval of dividend results in immediate cash outflow to the company, issue of bonus debentures defers the same.

Bonus Debentures v/s Bonus Shares: Issue of bonus shares does not alter the net worth of the company, whereas issue of bonus debentures results in decrease in equity and a corresponding increase in debt. This results in increase in the debt equity ratio of the company. Further, bonus shares do not involve any cash outlay. But bonus debentures involve outflows in the form of dividend distribution tax, periodical interest and outflow towards redemption of bonus debentures.

How does it impact Shareholders? As said above, issue of bonus debentures does not result in immediate receipt of cash by the shareholder. However, since these bonus debentures are generally listed on recognized stock exchanges, shareholders can sell these in secondary market. Going by the latest issued bonus debentures by Blue Dart Express Ltd. with coupon rate of 9.50% p.a. and redeemable after 5 years, it is being traded at Rs10.20 at BSE as against face value of Rs10. Hence, the shareholder would be able to pocket another gain of Rs0.20 per debenture by selling it in secondary market.

Further, since the issue of bonus debentures is treated as deemed dividend under the Income Tax Act, 1961, the company has to pay Dividend Distribution Tax on the face value of the debentures issued. Accordingly, the shareholder does not have to pay any further tax on the face value of debentures issued to him. However, the annual interest receipt and capital gain on sale of debentures (over and above the face value) shall be taxable in

the hands of the shareholders.

Why is not Popular? Despite all the inherent advantages of bonus debentures for the shareholder as well as the company, it is not a popular instrument. This is due to the fact that the issue of bonus debentures is not expressly covered under provisions of the Companies Act, 1956 or the Companies Act, 2013. Bonus debentures are therefore issued as a scheme of the arrangement under Section 391 to Section 394 of the Companies Act 1956 which involves procuring approvals of shareholders, High Court, Reserve Bank etc. Hence, the use of this way to reward shareholders gets discouraged due to lengthy and time consuming procedures.

Having come this far, it is really hoped that Companies Act also captures this innovative financial instrument soon and makes the process simpler for the companies. Till then, let's celebrate the issue of bonus debentures by NTPC. Any bonus is a good bonus, after all!