

Companies Act Fundamentals

Issue of Sweat Equity Shares



2020 MHA Legal

Applicable Law

- Chapter IV- Share Capital and Debentures - Section 43-72 of the Companies Act 2013
 - The Companies (Share Capital and Debentures) Rules, 2014.
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- Act means – Companies Act 2013
 - Rules means - The Companies (Share Capital and Debentures) Rules, 2014.

Issue of Sweat Equity Shares

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- Section 2(88) of the Act define “sweat equity shares” means such equity shares as are issued by a company to its directors or employees at a discount or for consideration, other than cash, for providing their know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.
- The rights, limitations, restrictions and provisions as are for the time being applicable to equity shares shall be applicable to the sweat equity shares issued under this section and the holders of such shares shall rank pari passu with other equity shareholders.
- The rules have defined ‘value additions’ to mean actual or anticipated economic benefits derived or to be derived by the company from an expert and/or a professional for providing know-how or making available rights in the nature of intellectual property rights, by such person to whom sweat equity is being issued for which the consideration is not paid or included in-

Issue of Sweat Equity Shares

- the normal remuneration payable under the contract of employment, in the case of an employee; and/or
- monetary consideration payable under any other contract, in the case of non-employee.

According to section 54 an unlisted company may issue sweat equity shares of a class of shares which has already been issued. The company shall satisfy the following conditions, namely:

- the issue is authorized by a special resolution passed by the company;
- the resolution specifies the number of shares, the current market price, consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued;
- not less than one year has, at the date of such issue, elapsed since the date on which the company had commenced business; and

Issue of Sweat Equity Shares

- where the equity shares of the company are listed on a recognized stock exchange, the sweat equity shares are issued in accordance with the regulations made by the Securities and Exchange Board in this behalf and if they are not so listed, the sweat equity shares are issued in accordance with such rules as may be prescribed.

Procedure for Issue of Sweat Equity Shares

- For listed companies, SEBI (Issue of Sweat Equity) Regulations, 2002 shall be applicable and for all other cases Companies (Share Capital and Debentures) Rules, 2014 rules shall be applicable.

- Rule 8 Under rules an unlisted company shall not issue sweat equity shares unless the issue is authorized by a special resolution passed by the company in general meeting.

- The rules for the purposes of sweat equity has defined 'Employee' so as to mean
 - a permanent employee of the company who has been working in India or outside India, for at least the last one year; or
 - a director of the company, whether a whole time director or not; or
 - an employee or a director as defined in sub-clauses (a) or (b) above of a subsidiary, in India or outside India, or of a holding company of the company.

Procedure for Issue of Sweat Equity Shares

- Explanatory Statement:

As mentioned earlier, special resolution shall be passed for the purpose of issue of sweat equity share, the explanatory statement to be annexed to the notice of the general meeting pursuant to section 102 shall contain the following particulars:

- the date of the Board meeting at which the proposal for issue of sweat equity shares was approved;
- the reasons/justification for the issue;
- the class of shares under which sweat equity shares are intended to be issued;
- the total number of shares to be issued as sweat equity;
- the class or classes of directors or employees to whom such equity shares are to be issued;
- principal terms and conditions on which sweat equity shares are to be issued, including basis of valuation;
- time period of association of such person with the company;

Procedure for Issue of Sweat Equity Shares

- the names of the directors or employees to whom the sweat equity shares will be issued and their relationship with the promoter or/and Key Managerial Personnel;
- the price at which the sweat equity shares are proposed to be issued;
- the consideration including consideration other than cash, if any to be received for the sweat equity;
- ceiling on managerial remuneration, if any, be breached by issuance of such sweat equity and how is it proposed to be dealt with;
- a statement to the effect that the company shall conform to the applicable accounting standards; and
- diluted Earning Per Share pursuant to the issue of sweat equity securities, calculated in accordance with the applicable accounting standards.

Others aspects of Sweat Equity Shares

- **Validity**: The special resolution authorizing the issue of sweat equity shares shall be valid for making the allotment within a period of not more than twelve months from the date of passing of the special resolution.
- **Maximum extent of Issue**: The company shall not issue sweat equity shares for more than 15% of the existing paid up equity share capital in a year or shares of the issue value of rupees five crores, whichever is higher. The issuance of sweat equity shares in the Company shall not exceed 25% of the paid up equity capital of the Company at any time.
- **Lock in period**: Sweat equity shares issued to directors or employees shall be locked in/non transferable for a period of three years from the date of allotment. The fact that the share certificates are under lockin and the period of expiry of lock in shall be stamped in bold or mentioned in any other prominent manner on the share certificate.

Others aspects of Sweat Equity Shares

- **Valuation**: The sweat equity shares to be issued shall be valued at a price determined by a registered valuer as the fair price giving justification for such valuation. The valuation of intellectual property rights or of know how or value additions for which sweat equity shares are to be issued, shall be carried out by a registered valuer, who shall provide a proper report addressed to the Board of directors with justification for such valuation. A copy of the valuation report obtained in both the above cases shall be sent to the share holders with the notice of the general meeting.

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Non-cash consideration

- Where sweat equity shares are issued for a non-cash consideration on the basis of a valuation report in respect thereof obtained from the registered valuer, such non-cash consideration shall be treated in the following manner in the books of account of the company:
 - (a) where the non-cash consideration takes the form of a depreciable or amortizable asset, it shall be carried to the balance sheet of the company in accordance with the accounting standards; or
 - (b) where clause (a) is not applicable, it shall be expensed as provided in the accounting standards.

Part of managerial remuneration

- Part of managerial remuneration: The amount of sweat equity shares issued shall be treated as part of managerial remuneration for the purposes of sections 197 and 198 of the Act if the following conditions are fulfilled:
 - (a) the sweat equity shares are issued to any director or manager; and
 - (b) they are issued for consideration other than cash, which does not take the form of an asset which can be carried to the balance sheet of the company in accordance with the applicable accounting standards.

Accounting

- In respect of sweat equity shares issued during an accounting period, the accounting value of sweat equity shares shall be treated as a form of compensation to the employee or the director in the financial statements of the company.
- If the shares are issued pursuant to acquisition of an asset, the value of the asset, as determined by the valuation report, shall be carried in the balance sheet as per the Accounting Standards and such amount of the accounting value of the sweat equity shares that is in excess of the value of the asset acquired, as per the valuation report, shall be treated as a form of compensation to the employee or the director in the financial statements of the company.

Disclosure in Directors' Report

- The Board of Directors shall, inter alia, disclose in the Directors' Report for the year in which such shares are issued, the following details of issue of sweat equity shares:
 - (a) Class of director/ employee to whom sweat equity shares were issued;
 - (b) Class of shares issued as Sweat Equity Shares;
 - (c) the number of sweat equity shares issued to the directors, key managerial personnel or other employees showing separately the number of such shares issued to them , if any, for consideration other than cash and the individual names of allottees holding one percent or more of the issued share capital;
 - (d) the reasons/justification for the issue;
 - (e) Principal terms and conditions for issue of sweat equity shares, including pricing formula;
 - (f) the total number of shares arising as a result of issue of sweat equity shares;

Disclosure in Directors' Report

- (g) percentage of the sweat equity shares of the total post issued and paid up share capital;
- (h) consideration (including consideration other than cash) received or benefit accrued to the company from the issue of sweat equity shares;
- (i) diluted Earnings Per Share (EPS) pursuant to issuance of sweat equity shares.

Register of Sweat Equity

- A Register of Sweat Equity Shares shall be maintained by the company in Form No. SH-3 and shall forthwith enter therein the particulars of Sweat Equity Shares issued under section 54.
- The Register of Sweat Equity Shares shall be maintained at the registered office of the company or such other place as the Board may decide.
- Entries in the register shall be authenticated by the Company Secretary of the company or by any other person authorized by the Board for the purpose.

Thank you



**Mind, Heart, Aspiration =
Passion, Integrity, Excellence**

Thank You

Please feel free to contact, if you need any further information or clarification:

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