

Sweat Equity (Sec 54)

1. Meaning of ‘sweat equity shares’

The definition provided in Section 2 (88) is as follows: ““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 definition of “value addition” provided in the Rule 8(1) of the Companies (Share Capital and Debentures) Rules, 2014 is as follows:

“the expression ‘Value additions’ means actual or anticipated economic benefits derived or to be derived by the company from an expert 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 the normal remuneration payable under the contract of employment, in the case of an employee.”

Sweat equity shares are issued by a company normally to compensate the employees/directors for contributing intangible asset in the form of technical know-how, value addition, and intellectual property rights etc by which the company arrives at some benefit.

2. Only type of share that can be issued at discount

Section 53 of the Act, prohibits issue of shares at discount, except as provided in section 54 it appears that. For companies other than listed companies which are not required to comply with SEBI regulations, sweat equity shares can be issued at discount, subject to compliance of requirements as specified under section 54, read with Rule 8 of The Companies (Share Capital and Debentures) Rules, 2014.

3. Applicability of SEBI Regulations

Where the equity shares of the company are listed on a recognized stock exchange, sweat equity shares should be issued in accordance with regulations made by the Securities and Exchange Board of India in this regard. Listed companies which are issuing sweat equity shares are required to comply with SEBI (Issue of Sweat Equity) Regulations, 2002.

4. Issue of Sweat Equity Shares is not a ‘preferential issue’

As per regulation 2(1)(z) of SEBI (ICDR) Regulations, 2009 which gives the meaning of a preferential issue excludes an issue of sweat equity shares there from, which means issue of sweat equity shares is not a preferential issue within the meaning of preferential issue

Further Rule 8 (13) of The Companies (Share Capital and Debentures) Rules, 2014, clearly excludes issue sweat equity shares from the definition of preferential offer.

5. Eligibility to receive sweat equity shares?

As given in the definition of “sweat equity shares” provided under Section 2(88), such equity can be issued either to directors or employees. The definition of “employee” is provided in the Rule 8 (1) of the Companies (Share Capital and Debentures) Rules, 2014 as follows:

“(i) the expressions “Employee” means

- (a) a permanent employee of the company who has been working in India or outside India, for at least last one year; or
- (b) a director of the company, whether a whole-time director or not; or
- (c) 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;”

Hence, a meaning wider than popular connotation is provided in the Rules.

6. Conditions for issue of sweat equity

For issue of sweat equity shares, there are following conditions which are to be fulfilled by the Company:

- a. The issue of sweat equity shall be authorized by way of special resolution. The said resolution shall specify the following details:
 - i. Number of shares
 - ii. Current market price
 - iii. Consideration, if any
 - iv. Class or classes of directors or employees to whom shares are to be issued
- b. On the date of issue, not less than 1 year has elapsed since the Company has commenced business
- c. Compliance of either Rule 8 (which includes the conditions dealt with below) or SEBI (Issue Of Sweat Equity) Regulations, 2002.

7. Validity of special resolution

The allotment is to be made within a period of not more than twelve months from the date of passing of the special resolution. If no allotment is made, the resolution no longer remains valid after this period.

8. Maximum cap on sweat equity

There are twin caps which are provided for issue of sweat equity. In one year, maximum value of sweat equity shares is 15% of the existing paid up equity share capital or shares of the issue value of Rs. 5 crores, whichever is higher. The other limit is overall limit which

provides that total issue of sweat equity shares in the Company shall not exceed 25% of the paid up equity capital of the Company at any time.

9. Lock-in period

The sweat equity shares so issued shall be locked in for a period of 3 years from the date of allotment. Further, it shall either be stamped in bold or mentioned in any other prominent manner on the share certificate the fact that the share certificates are under lock-in and the period of expiry of lock in.

10. Valuation requirements

For valuation of shares: The price of sweat equity shares shall be determined by a registered valuer which shall be their fair price and give justification for such valuation.

For valuation of benefits for which sweat equity is issued: The benefits for which sweat equity is issued which may be in the nature of intellectual property rights or know how or value additions (as defined above) are required to be valued. Such valuation shall be carried out by a registered valuer. He shall provide a proper report addressed to the Board of directors with justification for such valuation.

11. Accounting treatment

In case of non-cash consideration for sweat equity, such consideration shall be treated in the following manner:

- (a) where the non-cash consideration is in 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) in all other cases, it shall be expensed as provided in the accounting standards:
In cases where the non-cash consideration is expensed out, it will form part of managerial remuneration for the purposes of sections 197 and 198 of the Act. For employees and directors other than the above case, it shall be treated as a form of compensation to the employee or the director.

Where the consideration has resulted in acquisition of an asset, the value of the asset as per the valuation report shall be carried in the balance sheet as per the Accounting Standards. In case, the value of shares exceeds the value of assets acquired it shall be treated as a form of compensation to the employee or the director.

12. Pari-passu Ranking with equity shareholders:

As per Section 54(2), the right, limitations, restrictions and provisions as are applicable to existing equity shares shall be applicable to sweat equity shares issued under this section and the holders of such shares rank pari-passu with other equity shareholders.

13. Requirement of Maintenance of register:

Companies which have issued sweat equity shares are required to maintain a register of sweat equity shares in Form No- SH.3. Entries shall be made forthwith.

The said Register of Sweat Equity Shares is to be maintained at the registered office of the company. The Board is authorised to change the same to any other place as the may be decided. The entries in the said register shall be authenticated by the Company Secretary or by any other person authorized by the Board for the purpose.

14. Disclosure in the Board's Report

The Board of Directors are required to disclose the following details in the Directors' Report prepared for the year in which such sweat equity shares are issued:

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

15. Start-up Companies

With effect from 19.07.2016, a start-up company as defined in notification no. G.S.R. 180 (E) dated 17.02.2016, issued by the Department of Industrial Policy and Promotions, Ministry Commerce and Industry Govt. of India can issue sweat equity shares upto 50% of paid up capital upto 5 years from the date of incorporation of regulation.
