

## Ch. 6 CONCEPT OF CAPITAL AND FINANCING OF COMPANIES

<b>Capital</b>	<p>In relation to a company limited by shares, the word “capital” means the share capital i.e., the capital in terms of rupees divided into specified number of shares of a fixed amount each.</p> <p>For example, share capital of a company is Rs.1,00,000 which can be divided into 10,000 shares of Rs. 10 each.</p>
<b>THE WORD “CAPITAL” IN DIFFERENT FORMS</b>	
<b>Nominal, Authorized or Registered Capital</b>	<p>According to section 2(8), “authorized capital” or “nominal capital” means such capital as is authorized by the memorandum of a company to be the maximum amount of share capital of the company.</p> <p>A company pays the prescribed fees for Authorized Capital at the time of registration.</p>
<b>Issued Capital</b>	<p>According to section 2(50), “issued capital” means such capital as the company issues from time to time for subscription.</p> <p>It is that part of the authorized or nominal capital which the company issues for the time being for public subscription and allotment. This is computed at the face or nominal value.</p>
<b>Subscribed Capital</b>	<p>According to Section 2(86), “subscribed capital” means such part of the capital which is for the time being subscribed by the members of a company.</p> <p>It is that portion of the issued capital at face value which has been subscribed for or taken up by the subscribers of shares in the company.</p> <p>It is clear that the entire issued capital may or may not be subscribed.</p>
<b>Called up Capital</b>	<p>According to section 2(15), “called-up capital” means such part of the subscribed capital, which has been called for payment or demanded on the shares by the company.</p>
<b>Paid-up Share Capital</b>	<p>According to section 2(64), “paid-up share capital” or “share capital paid-up” means the amount received as paid-up in respect of shares issued.</p>

### Preference and Equity Share Capital (Section 43)

<b>Equity share capital</b>	<p>Equity share capital with reference to any company limited by shares, means all share capital which is not preference share capital.</p> <p>Equity share capital may be issued —</p> <ul style="list-style-type: none"><li>(i) with voting rights; or</li><li>(ii) with differential rights as to dividend, voting or otherwise in accordance with such rules as may be prescribed.</li></ul>
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	Equity share capital may be issued with similar rights or equity shares with different voting rights as described in <b>Rule 4 of Companies (Share Capital and Debentures) Rules, 2014.</b>
<b>Preference share capital</b>	Preference share capital with reference to any company limited by shares, means that part of the issued share capital of the company which carries or would carry a preferential right with respect to— (a) payment of dividend, either as a fixed amount or an amount calculated at a fixed rate, and (b) repayment of the amount of the share capital paid-up in the case of a winding up.
<p>Section 47(2) states that every member of a company limited by shares and holding any preference share capital therein shall have a right to vote</p> <ul style="list-style-type: none"> <li>(i) only on resolutions placed before the company which directly affect the rights attached to his preference shares and,</li> <li>(ii) on any resolution for the winding up of the company or for the repayment or reduction of its equity or preference share capital, and</li> <li>(iii) his voting right on a poll shall be in proportion to his share in the paid-up preference share capital of the company:</li> </ul> <p>However, where the dividend in respect of preference shares has not been paid for a period of two years or more, such preference shareholders shall have a right to vote on all the resolutions placed before the company.</p>	

### **MEANING OF A SHARE**

Section 2(84) of the Act defines a share as “a share in the share capital of a company, and includes stock except where a distinction between stock and shares is expressed or implied.

#### **Nature of a Share**

1. A share is a right to a specified amount of the share capital of a company, carrying with it certain rights and liabilities while the company is a going concern and in its winding up. (Halsbury's Laws of England)

**Halsbury's Laws of England** is a unique, comprehensive and authoritative encyclopedia of law, and provides the only complete narrative statement of law in England.

2. A share is the interest of a shareholder in the company measured by a sum of money.

3. A share is a right to participate in the profits made by a company, while it is a going concern and declares a dividend and in the assets of company when it is wound up [**Bacha Guzdar vs. CIT**].

4. A share is not a sum of money but a bundle of rights and liabilities; it is an interest measured by a sum of money. These rights and liabilities are regulated by the articles of a company.

5. Section 44 of the Companies Act provides that a share of any member in a company is a movable property transferable in the manner provided by the articles of the company.

6. According to Section 45 of the Companies Act, 2013 every share in a company having a share capital shall be distinguished by its distinctive number.

<b>Distinction between Equity Share and Preference Share</b>		
<b>Basis</b>	<b>Equity Share</b>	<b>Preference Share</b>
<b>Rate of Dividend</b>	The rate of dividend on equity shares depends upon the amount of profit available.	Preference shares are entitled to a fixed rate of dividend.
<b>Dividend when paid</b>	The dividend on equity shares is paid only after the dividend on preference shares has been paid.	Dividend on the preference shares is paid in preference to the equity shares.
<b>Cumulative</b>	Dividend is not cumulative.	Dividend on preference share may be cumulative.
<b>Voting Rights</b>	An equity shareholder can vote on all matters affecting the company.	The voting rights of preference shareholders are restricted.
<b>Bonus Shares / Right Shares</b>	A company may issue rights shares or bonus shares to the company's existing equity shareholders.	No bonus shares/right shares are issued to preference shareholders.
<b>Redemption</b>	Equity shares cannot be redeemed except under a scheme involving reduction of capital or buy back of its own shares.	Redeemable preference shares may be redeemed by the company.

#### **ISSUE OF SECURITIES AT A PREMIUM**

A company may issue securities at a premium when it is able to sell them at a price above par or above nominal value.

The Companies Act, 2013, does not stipulate any conditions or restrictions regulating the issue of securities by a company at a premium.

However, the Companies Act does impose conditions regulating the utilization of the amount of premium collected on securities. The Share Premium is to be transferred to 'securities premium account'.

<b>Utilization of Securities premium</b>	According to Section 52(2) of the Act, the securities premium can be utilized only for: (a) issuing fully paid bonus shares to members; (b) writing off the balance of the preliminary expenses of the company; (c) writing off commission paid or discount allowed, or the expenses incurred on issue of shares or debentures of the company; (d) for providing for the premium payable on redemption of any redeemable preference shares or debentures of the company; or (e) for the purchase of its own shares or other securities under section 68.
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#### **NOTE:**

1. The premium cannot be treated as profit and as such the amount of premium is not available for distribution as dividend.

2. The amount of premium whether received in cash or in kind must be kept in a separate account, known as the “Securities Premium Account”.
3. The amount of premium is to be maintained with the same sanctity as the share capital.
4. Any premium paid does not give the shareholder any preferential rights in case of a winding up.
5. Monies in the securities premium account cannot be treated as free reserves, as they are in the nature of capital reserve.

Where a company issues shares at a premium, even though the consideration may be other than cash, a sum equal to the amount or value of the premium must be transferred to the securities premium account. [**Head (Henry) & Co. Ltd. vs. Ropner Holding Ltd.**]

### **PROHIBITION TO ISSUE THE SHARES AT DISCOUNT**

Section 53 states that except as provided in section 54 (i.e., issue of sweat equity shares), a company shall not issue shares at a discount.

Any share issued by a company at a discounted price shall be void.

When a **company** contravenes the provisions of this section, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees and

**every officer** who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees, or with both.

### **ISSUE OF SWEAT EQUITY SHARES**

#### **Meaning**

According to section 2(88), sweat equity shares mean equity shares issued by a company to its directors or employees at a discount or for consideration, other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

#### **Rule 8(1) of Companies (Share Capital and Debentures) Rules, 2014.**

(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.

(ii) 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.

<b>Rationale</b>	Section 54 permits issue of such equity shares to employees or directors in recognition of their contribution for providing know-how etc. as aforesaid. As the contribution made by employees /directors results in increased profits to the company for a number of years, sweat equity shares, provide a new form of adequate return.
<b>Conditions for Issue of Sweat Equity Shares</b>	Section 54(1) provides that a company can issue sweat equity shares, of a class of shares already issued, if the following conditions are satisfied: (i) the issue has been authorized by a special resolution passed by the company in the general meeting. (ii) the following are clearly specified in the resolution: (a) number of shares; (b) current market price; (c) consideration, if any; and (d) class or classes of directors or employees to whom such equity shares are to be issued. (iii) as on the date of issue, at least one year should have elapsed from the date on which the company had commenced business. (iv) a company whose shares are listed on a recognized stock exchange issuing sweat equity shares should comply with the regulations made in this behalf by SEBI. (v) a company whose shares are not so listed should issue sweat equity shares in compliance with the rules made in this behalf by the Central Government (i.e., <b>Companies (Share Capital and Debentures) Rules, 2014</b> )
Section 54(2) provides that holders of Sweat Equity Shares to be ranked pari-passu with other Equity shareholders.	

**COMPANIES (SHARE CAPITAL AND DEBENTURES) RULES, 2014- ASPECTS RELATING TO SWEAT EQUITY SHARES**

**Explanatory statement to Special Resolution to contain certain particulars**

**Rule 8(2)** states that the explanatory statement to be annexed to the notice of the general meeting shall contain the following particulars, namely: -

- (a) the date of the Board meeting at which the proposal for issue of sweat equity shares was approved;
- (b) the reasons or justification for the issue;
- (c) the class of shares under which sweat equity shares are intended to be issued;
- (d) the total number of shares to be issued as sweat equity;
- (e) the class or classes of directors or employees to whom such equity shares are to be issued;
- (f) the principal terms and conditions on which sweat equity shares are to be issued, including basis of valuation;
- (g) the time period of association of such person with the company;
- (h) 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;
- (i) the price at which the sweat equity shares are proposed to be issued;
- (j) the consideration including consideration other than cash, if any to be received for the sweat equity;

<p>(k) the ceiling on managerial remuneration, if any, be breached by issuance of such sweat equity and how it is proposed to be dealt with;</p> <p>(l) a statement to the effect that the company shall conform to the applicable accounting standards; and</p> <p>(m) diluted Earning Per Share pursuant to the issue of sweat equity shares.</p>	
<b>Validity of Special Resolution authorizing sweat equity shares</b>	<b>Rule 8(3)</b> 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.
<b>Limits on issue of sweat equity shares</b>	<p><b>Rule 8(4)</b> states that the company shall not issue sweat equity shares for more than fifteen percent of the existing paid up equity share capital in a year or shares of the issue value of rupees five crores, whichever is higher.</p> <p>The issuance of sweat equity shares in the Company shall not exceed twenty-five percent, of the paid up equity capital of the Company at any time.</p>
<b>Locked for three years</b>	The sweat equity shares issued to directors or employees shall be locked in/non-transferable for a period of <b>three years</b> from the date of allotment.
<b>Valuation aspects</b>	<p><b>Rule 8(6)</b> states that 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.</p> <p><b>Rule 8(7)</b> states that 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.</p> <p><b>Rule 8(8)</b> states that a copy of gist along with critical elements of the valuation report obtained under Rule 8 (6) and Rule 8 (7) shall be sent to the shareholders with the notice of the general meeting.</p>

#### **Board's Report to disclose the details of sweat equity shares**

Rule 8(13) states that 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 namely: -

- (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.

**Maintenance of Register [Rule 8 (14) (a)]**

The company shall maintain a Register of Sweat Equity Shares 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.

The 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.

**SHARES WITH DIFFERENTIAL VOTING RIGHTS**

Section 43 enables companies to issue a variety of equity shares with differential rights etc.

**Rule 4 of Companies (Share Capital and Debentures) Rules, 2014** states the following conditions regarding shares with differential voting rights.

**Conditions**

No company limited by shares shall issue equity shares with differential rights as to dividend, voting or otherwise, unless it complies with the following conditions, namely:

- (a) the AOA of the co. authorizes the issue of shares with differential rights;
- (b) the issue of shares is authorized by an ordinary resolution passed at a general meeting of the shareholders:  
When the equity shares of a company are listed on a recognized stock exchange, the issue of such shares shall be approved by the shareholders through postal ballot;
- (c) the shares with differential rights shall not exceed twenty-six percent of the total post-issue paid up equity share capital including equity shares with differential rights issued at any point of time;
- (d) the company having consistent track record of distributable profits for the last three years;
- (e) the company has not defaulted in filing financial statements and annual returns for three financial years immediately preceding the financial year in which it is decided to issue such shares;
- (f) the company has no subsisting default in the payment of a declared dividend to its shareholders or repayment of its matured deposits or redemption of its preference shares or debentures that have become due for redemption or payment of interest on such deposits or debentures or payment of dividend;

(g) the company has not defaulted in payment of the dividend on preference shares or repayment of any term loan from a public financial institution or Bank that has become repayable or dues with respect to statutory payments relating to its employees to any authority or default in crediting the amount in Investor Education and Protection Fund to the Central Government;

(h) the company has not been penalized by Court or Tribunal during the last three years of any offence under the Reserve Bank of India Act, 1934, the Securities and Exchange Board of India Act, 1992 the Securities Contracts Regulation Act, 1956, the Foreign Exchange Management Act, 1999 or any other special Act, the Securities Contracts Regulation Act, 1956, the Foreign Exchange Management Act, 1999 or any other special Act, under which such companies being regulated by sectoral regulators.

#### **Disclosures in the explanatory statement to the notice of the meeting**

**Rule 4(2) of Companies (Share Capital and Debentures) Rules, 2014** states that the explanatory statement to be annexed to the notice of the general meeting in pursuance of section 102 or of a postal ballot in pursuance of section 110 shall contain the following particulars, namely: -

(a) the total number of shares to be issued with differential rights;

(b) the details of the differential rights;

(c) the percentage of the shares with differential rights to the total post issue paid up equity share capital including equity shares with differential rights issued at any point of time;

(d) the reasons or justification for the issue;

(e) the price at which such shares are proposed to be issued either at par or at premium;

(f) the basis on which the price has been arrived at;

(g) (i) in case of private placement or preferential issue-

(a) details of total number of shares proposed to be allotted to promoters, directors and KMP;

(b) details of total number of shares proposed to be allotted to persons other than promoters,

directors and KMP and their relationship if any with any promoter, director or KMP;

(ii) in case of public issue - reservation, if any, for different classes of applicants including promoters, directors or KMP;

(h) the change in control, if any, in the company that may occur consequent to the issue of equity shares with differential voting rights;

(i) the diluted Earnings Per Share pursuant to the issue of such shares, calculated in accordance with the applicable accounting standards;

(j) the pre and post issue shareholding pattern along with voting rights.

**Rule 4(3)** states that the company shall not convert its existing equity share capital with voting rights into equity share capital carrying differential voting rights and *vice-versa*.

## **Disclosures in the Boards' Report**

**Rule 4(4)** states that the Board of Directors shall, inter alia, disclose in the Board's Report for the financial year in which the issue of equity shares with differential rights was completed, the following details, namely: -

- (a) the total number of shares allotted with differential rights;
- (b) the details of the differential rights relating to voting rights and dividends;
- (c) the percentage of the shares with differential rights to the total post issue equity share capital with differential rights issued at any point of time and percentage of voting rights which the equity share capital with differential voting right shall carry to the total voting right of the aggregate equity share capital;
- (d) the price at which such shares have been issued;
- (e) the particulars of promoters, directors or key managerial personnel to whom such shares are issued;
- (f) the change in control, if any, in the company consequent to the issue of equity shares with differential voting rights;
- (g) the diluted Earnings Per Share pursuant to the issue of each class of shares, calculated in accordance with the applicable accounting standards;

**Rule 4(5)** states that the holders of the equity shares with differential rights shall enjoy all other rights such as bonus shares, rights shares etc., which the holders of equity shares are entitled to, subject to the differential rights with which such shares have been issued.

**Rule (6)** states that when a company issues equity shares with differential rights, the Register of Members maintained under section 88 shall contain all the relevant particulars of the shares so issued along with details of the shareholders.

## **ISSUE AND REDEMPTION OF PREFERENCE SHARES**

Section 55. (1) states that no company limited by shares shall issue any preference shares which are irredeemable.

Section 55(2) further states that a company limited by shares may, if so authorized by its articles, issue preference shares which are liable to be redeemed within a period not exceeding twenty years from the date of their issue.

### ***Exceptions***

#### **Issue and redemption of preference shares by company in infrastructure projects**

##### **Condition:**

**Rule 10** states that a company engaged in the setting up and dealing with of infrastructural projects may issue preference shares for a period exceeding twenty years but not exceeding thirty years, subject to the redemption of a minimum ten percent of such preference shares per

year from the twenty first year onwards or earlier, on proportionate basis, at the option of the preference shareholders.

**Other conditions:**

Proviso to Section 55(2) states that

- (a) no such shares shall be redeemed except out of the profits of the company which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares made for the purposes of such redemption;
- (b) no such shares shall be redeemed unless they are fully paid;
- (c) where such shares are proposed to be redeemed out of the profits of the company, there shall, out of such profits, be transferred, a sum equal to the nominal amount of the shares to be redeemed, to a reserve, to be called the Capital Redemption Reserve Account; and
- (d) the premium, if any, payable on redemption shall be provided for out of the profits of the company, before the shares are redeemed.

**Prescriptions under Companies (Share Capital and Debentures) Rules, 2014 with regard to issue and redemption of Preference shares**

**Conditions**

**Rule 9(1)** states that a company having a share capital may, if so authorized by its articles, issue preference shares subject to the following conditions, namely: -

- (a) the issue of such shares has been authorized by passing a special resolution in the general meeting of the company
- (b) the company, at the time of such issue of preference shares, has no subsisting default in the redemption of preference shares issued either before or after the commencement of this Act or in payment of dividend due on any preference shares.

**Resolution authorizing preference shares to set out certain particulars**

**Rule 9(2)** states that a company issuing preference shares shall set out in the resolution, particulars in respect of the following matters relating to such shares, namely: -

- (a) the priority with respect to payment of dividend or repayment of capital vis-a-vis equity shares;
- (b) the participation in surplus fund;
- (c) the participation in surplus assets and profits, on winding-up which may remain after the entire capital has been repaid;
- (d) the payment of dividend on cumulative or non-cumulative basis.
- (e) the conversion of preference shares into equity shares.
- (f) the voting rights;
- (g) the redemption of preference shares

**Explanatory Statement**

**Rule 9(3)** states that the explanatory statement to be annexed to the notice of the general meeting shall, inter-alia, provide the complete material facts concerned with and relevant to the issue of such shares including-

- (a) the size of the issue and number of preference shares to be issued and nominal value of each share;
- (b) the nature of such shares i.e. cumulative or non - cumulative, convertible or non - convertible
- (c) the objectives of the issue;
- (d) the manner of issue of shares;

- (e) the price at which such shares are proposed to be issued;
- (f) the basis on which the price has been arrived at;
- (g) the terms of issue, including terms and rate of dividend on each share, etc.;
- (h) the terms of redemption, including the tenure of redemption, redemption of shares at premium and if the preference shares are convertible, the terms of conversion;
- (i) the manner and modes of redemption;
- (j) the current shareholding pattern of the company;
- (k) the expected dilution in equity share capital upon conversion of preference shares.

### **Register of Members**

**Rule 9(4)** states that when a company issues preference shares, the Register of Members maintained under section 88 shall contain the particulars in respect of such preference share holder(s).

### **Redemption of preference shares**

Rule 9(6) states that a company may redeem its preference shares only on the terms on which they were issued or as varied after due approval of preference shareholders under section 48 of the Act and the preference shares may be redeemed: -

- (a) at a fixed time or on the happening of a particular event;
- (b) any time at the company's option; or
- (c) any time at the shareholder's option

## **PUBLICATION OF AUTHORISED, SUBSCRIBED AND PAID-UP CAPITAL**

Section 60 (1) states that when any notice, advertisement or other official publication, or document of a company contains a statement of the amount of the authorized capital of the company, such notice, advertisement or other official publication or document shall also contain a statement, in an equally prominence of the amount of the capital which has been subscribed and the amount paid-up.

Section 60 (2) states that any default is made in complying with the requirements of sub-section (1), the company shall be liable to pay a penalty of ten thousand rupees and every officer of the company who is in default shall be liable to pay a penalty of five thousand rupees, for each default.

## **FURTHER ISSUE OF SHARES OR RIGHT SHARES**

<b>Right Shares</b>	Section 62 of the Companies Act provides for the issue of "Rights Shares" and states that whenever at any time, a company having a share capital proposes to increase its subscribed capital by the issue of further shares, such shares shall be offered to the <b>existing holders of equity shares</b> in proportion to the paid-up share capital on their shares at the time of further issue by sending a letter of offer.
<b>Listed companies</b>	For listed companies, the information as regards the quantum of such issue and the proportion in which rights shall be offered shall be supplied to the concerned Stock Exchanges in advance.
<b>Time prescribed</b>	The company must give notice to each of the equity shareholders, giving him option to take the shares offered to him by the company. The shareholder must

	<p>be informed of the number of shares he may opt to buy giving him at least 15 days but not more than 30 days to decide.</p> <p>The said notice shall be dispatched through registered post or through electronic mode to all the existing shareholders at least 3 days before the opening of the issue.</p>
<b>No Reply</b>	<p>The directors must state in the notice of offer of rights shares the fact that the shareholder has also the right to renounce the offer in whole or in part, in favor of some other persons.</p> <p>If the shareholder does not convey to the company his acceptance of the company's offer of further shares he shall be deemed to have declined the offer. If a shareholder has neither renounced in favor of another person nor accepted the shares, the Board of directors may dispose of the shares so declined in such manner which is not dis-advantageous to the shareholders and the company.</p>
<b>Shares to its employees</b>	<p>Section 62(1)(b) provides that a company may issue further shares to its employees under a scheme of employees' stock option, subject to special resolution passed by company and subject to such conditions as may be prescribed.</p>
<b>Shares to persons other than existing shareholders</b>	<p>Section 62(1)(c) deals with issue of shares to persons other than existing shareholders and provides that a company can issue further shares to persons other than existing shareholders either for cash or for a consideration other than cash, if —</p> <p>(1) the company in General Meeting passes a special resolution to this effect; and</p> <p>(2) the price of such shares is determined by the valuation report of a registered valuer subject to such conditions as may be prescribed.</p>
<p>The provisions of section 62 are applicable to all types of companies.</p>	

**Nanalal Zaver v. Bombay Life Assurance Co. Ltd.,**

Section 81 (Corresponding to section 62 of the Companies Act, 2013) is intended to cover cases where the directors decide to increase the capital by issuing further shares within the authorized limit, because it is within that limit that the directors can decide to issue further shares, unless, of course, they are precluded from doing that by the Articles of Association of the company. Accordingly, the section becomes applicable only when the directors decide to increase the capital within the authorized limit, by issue of further shares.

The above judgement was followed by the Supreme Court in **Needle Industries (India) Ltd. v. Needle Industries Newey (India) Holding Ltd.**

The Court pointed out that the directors of a company must exercise their powers for the benefit of the company. The directors are in a fiduciary position and if they do not exercise powers for the benefit of the company but simply and solely for personal gains and to the detriment of the company, the court will interfere and prevent the directors from doing so,

The power to issue shares need not be used only when there is a need to raise additional capital. The power can be used to create a sufficient number of shareholders to enable a company to enable it to comply with statutory requirements.

**Worldwide Agencies (P) Ltd. v. Margaret T. Desor,**

It was held that persons who have become entitled to the shares of a deceased member can exercise all the membership rights of the deceased irrespective of the fact whether their name is in the register of members or not.

**BONUS SHARES**

<b>Meaning</b>	When a company earns a lot of money and accumulates large distributable profits, it converts these accumulated profits into capital and divides the capital among the existing members in proportion to their entitlements. Members do not have to pay any amount for such shares. They are given free. Issue of bonus shares is a bare machinery for capitalizing undistributed profits.
<b>Advantages of Issuing Bonus Shares</b>	<ol style="list-style-type: none"> <li>1. Fund flow is not affected adversely.</li> <li>2. Market value of the members' shareholdings increases with the increase in number of shares in the company.</li> <li>3. Bonus shares is not an income. Hence it is not a taxable income.</li> <li>4. Paid-up share capital increases with the issue of bonus shares.</li> </ol>
<b>Sources for issue of Bonus shares</b>	According to section 63(1), a company may issue fully paid-up bonus shares to its members, in any manner whatsoever, out of— <ol style="list-style-type: none"> <li>(i) its free reserves;</li> <li>(ii) the securities premium account; or</li> <li>(iii) the capital redemption reserve account.</li> </ol>
<b>NOTE:</b> No issue of bonus shares shall be made by capitalizing reserves created by the revaluation of assets.	
<b>Conditions for issue of Bonus Shares</b>	According to section 63(2), no company shall capitalize its profits or reserves for the purpose of issuing fully paid-up bonus shares, unless— <ol style="list-style-type: none"> <li>(a) it is authorized by its articles;</li> <li>(b) it has, on the recommendation of the Board, been authorized in the general meeting of the company;</li> <li>(c) it has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it;</li> <li>(d) it has not defaulted in respect of the payment of statutory dues of the employees, such as, contribution to provident fund, gratuity and bonus;</li> <li>(e) the partly paid-up shares, if any outstanding on the date of allotment, are made fully paid-up.</li> </ol>
<b>No Bonus shares in lieu of dividend</b>	The bonus shares shall not be issued in lieu of dividend. [Section 63(3)]. Under <b>Companies (Share Capital and Debentures) Rules, 2014</b> with regard to issue of Bonus Share, <b>Rule 14</b> states that the company which has once announced the decision of its Board recommending a bonus issue, shall not subsequently withdraw the same.

**EMPLOYEE STOCK OPTION SCHEME**

<b>Meaning</b>	According to Section 2(37), the term 'Employee Stock Option' (ESOP) has been means the option given to the directors, officers or employees of a
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	company or of its holding company or subsidiary company or companies, if any, which gives such directors, officers or employees, the benefit or right to purchase, or to subscribe for, the shares of the company at a future date at a pre-determined price.
<b>Special Resolution</b>	A company may issue further shares to its employees under a scheme of employees' stock option, subject to <b>special resolution passed by company and</b> subject to such conditions as may be prescribed. <b>Rule 12 of Companies (Share Capital and Debentures) Rules, 2014</b> with regard to issue of Employee stock options covers issue of ESOPs.
<b>Who is an employee for the purpose of Section 62(1)(b)</b>	(a) a permanent employee of the company who has been working in India or outside India; or (b) a director of the company, whether a whole time director or not but excluding an independent director; or (c) an employee as defined in clauses (a) or (b) of a subsidiary, in India or outside India, or of a holding company of the company or of an associate company but does not include- (i) an employee who is a promoter or a person belonging to the promoter group; or (ii) a director who either himself or through his relative or through any body-corporate, directly or indirectly, holds more than ten percent of the outstanding equity shares of the company.
<b>Disclosures in explanatory statement</b>	<b>Rule 12 (2)</b> states that the company shall make the following disclosures in the explanatory statement annexed to the notice for passing of the resolution- (a) total number of stock options to be granted; (b) identification of classes of employees entitled to participate in the Employees Stock Option Scheme; (c) the appraisal process for determining the eligibility of employees to the Employees Stock Option Scheme; (d) the requirements of vesting and period of vesting; (e) the maximum period within which the options shall be vested; (f) the exercise price or the formula for arriving at the same; (g) the exercise period and process of exercise; (h) the Lock-in period, if any; (i) the conditions under which option vested in employees may lapse e.g. in case of termination of employment for misconduct.
<b>Free pricing in conformity with accounting policies</b>	<b>Rule 12(3)</b> states that the companies granting option to its employees pursuant to Employees Stock Option Scheme will have the freedom to determine the exercise price in conformity with the applicable accounting policies, if any.
<b>For Holding / Subsidiary Co.</b>	<b>Rule 12 (4)</b> states that a separate resolution for granting options to employees of holding/subsidiary companies etc. shall be passed.

<b>Varying terms of ESOP</b>	<b>Rule 12(5)</b> The company may by special resolution, vary the terms of Employees Stock Option Scheme not yet exercised by the employees provided such variation is not prejudicial to the interests of the option holders.
<b>Minimum one year vesting period</b>	<b>Rule 12 (6)(a)</b> states that there shall be a minimum period of one year between the grant of options and vesting of option.
<b>Lock-in period</b>	<b>Rule 12(6)(b)</b> states that the company shall have the freedom to specify the lock-in period for the shares issued pursuant to exercise of option.
<b>No right of dividend or voting</b>	<b>Rule 12(6)(c)</b> states that the Employees shall not have right to receive any dividend or to vote or in any manner enjoy the benefits of a shareholder in respect of option granted to them, till shares are issued on exercise of option.
<b>Forfeiture/ refund</b>	<b>Rule 12(7)</b> states that the amount, if any, payable by the employees, at the time of grant of option- (a) may be forfeited by the company if the option is not exercised by the employees within the exercise period; or (b) the amount may be refunded to the employees if the options are not vested due to non-fulfillment of conditions relating to vesting of option as per the Employees Stock Option Scheme.
<b>Conditions</b>	<b>Rule 12(8)</b> states the following conditions: <ul style="list-style-type: none"> <li>• The option granted to employees shall not be transferable to any other person.</li> <li>• The option granted to the employees shall not be pledged, hypothecated, mortgaged or otherwise encumbered or alienated in any other manner.</li> <li>• No person other than the employees to whom the option is granted shall be entitled to exercise the option.</li> </ul>
<b>Death/ permanent disability/ resignation of employees who were granted with options</b>	<b>Rule 12(8)</b> states that in the event of the death of employee while in employment, all the options granted to him till such date shall vest in the legal heirs or nominees of the deceased employee. In case the employee suffers a permanent incapacity while in employment, all the options granted to him as on the date of permanent incapacitation, shall vest in him on that day. In the event of resignation or termination of employment, all options vested in the employee as on that day shall expire.
<b>Maintenance of Register</b>	<b>Rule 12(10)</b> states that the company shall maintain a Register of Employee Stock Options in <b>Form No. SH-6</b> . The Register of Employee Stock Options shall be maintained at the registered office of the company or such other place as the Board may decide.

### **ISSUE OF SHARES ON PREFERENTIAL BASIS**

According to Section 62(1)(c), a company can issue further shares to persons other than existing shareholders either for cash or for a consideration other than cash, if —

- (1) the company in General Meeting passes a special resolution to this effect; and
- (2) the price of such shares is determined by the valuation report of a registered valuer.

<b>Meaning of Preferential Offer</b>	The expression 'Preferential Offer' means an issue of shares or other securities, by a company to any select person or group of persons on a preferential basis and does not include shares or other securities offered through a public issue, rights issue, employee stock option scheme, or an issue of sweat equity shares or bonus shares or depository receipts issued in a country outside India or foreign securities.
<b>RULE 13 OF COMPANIES (SHARE CAPITAL AND DEBENTURES) RULES, 2014</b>	
<ul style="list-style-type: none"> <li>• Pass special resolution</li> <li>• Listed company shall follow SEBI regulations</li> <li>• Issue to be authorized by the articles</li> <li>• Securities to be made fully paid up on allotment</li> <li>• Disclosures to be made in explanatory statement to be annexed to the notice of general meeting</li> <li>• Allotment to get completed within 12 months if not completed a fresh resolution is required</li> <li>• Price determination by the registered valuer's report</li> </ul>	