Clasis Corporate Services

Issuance of the Sweat Equity Shares in India

Sweat equity shares, as defined under the Companies Act, 2013 ("**CA 2013**") are equity shares issued by a company to its employees or directors 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.

Here "value additions" means actual or anticipated economic benefits derived or to be derived by the company from an expert opinion or 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.

Some of the key provisions of the CA 2013 regarding sweat equity shares, *inter alia* include the following:

1. **Approval Requirement**: The issuance of sweat equity shares requires approval from the shareholders of the company through a special resolution passed at a general meeting. Such resolution shall specify the number of shares, current market price, consideration, if any, and the class or classes of directors or employees to whom these are to be issued.

2. **Explanatory Statement**: The explanatory statement to be annexed to the notice of the general meeting shall, *inter alia* comprise of reason or justification of issuance of sweat equity shares, principal terms and conditions, basis of valuation, names of directors and employees to whom shares are to be issued.

3. **Maximum Limit**: The sweat equity shares to be issued by a company in a year shall not exceed 15% of the existing paid-up equity share capital or the issue value of INR 50 million of shares, whichever is higher. Further, the sweat equity shares issued in a company shall not exceed 25% of the paid-up equity capital at any time.

4. **Valuation**: The sweat equity shares to be issued shall be valued at a price determined by a registered valuer as fair price along with the justification for such valuation. Similarly, in case the sweat equities are to be issued against intellectual property rights, know how or value additions, the valuation shall be carried out by a registered valuer.

5. **Lock-in Period**: The sweat equity shares issued to directors or employees are subject to a lock-in period of three years from the date of allotment.

6. **Managerial remuneration**: In case the sweat equity shares are issued to any director or manager, and these 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, the amount of sweat equity shares issued shall be treated as part of managerial remuneration under sections 197, 198 and other applicable provisions of the CA 2013.

7. **Disclosure requirements**: The Board in its report for the year in which sweat equity shares are issued, shall disclose the requisite details with respect to such issuance.

In addition to the aforesaid provisions of the CA 2013, the Securities and Exchange Board of India ("**SEBI**") has also laid down guidelines regarding the issuance of sweat equity shares under SEBI (Share based Employee Benefits and Sweat Equity) Regulations, 2021 ("**SEBI Regulations**") for issuance of sweat equity shares by the listed companies. SEBI Regulation *inter alia* includes the following:

1. **Issuance to promoter or promoter group:** The issuance of sweat equity shares to employees who belong to promoter or promoter group shall be approved by way of a resolution passed by simple majority of the shareholders in a general meeting. However, the promoters and promoters' group shall not participate in such resolution.

2. **Pricing:** Price of sweat equity shares shall be determined in accordance with the pricing requirements provided under SEBI (Issue of Capital and Disclosure Requirements), 2018.

3. **Valuation:** The valuation of know-how or intellectual property rights or value addition, against which the sweat equity shares are being issued, shall be carried out by a merchant banker. The merchant banker shall obtain a certificate from an independent Chartered Accountant certifying that the valuation is in accordance with the applicable accounting standards.

4. **Auditor's certificate:** Once the sweat equity shares are issued, the Board of directors shall place a certificate *(duly obtained from the secretarial auditor of the company)* before the shareholders in the subsequent general meeting certifying that the issue of sweat equity shares have been made in accordance with the Regulations.

5. **Disclosure requirements**: Within seven (7) days of the issuance of sweat equity shares, the company shall send a statement to the recognised stock exchange disclosing the particulars of issuance, such as, number of shares issued, total amount received, consequent changes in the capital structure and shareholding pattern of the company.

Conclusion

Sweat equity shares serve as a valuable tool for companies to reward their employees and directors for their contributions towards the company's growth and success. However, it is essential for companies to comply with the regulatory framework laid down by the CA 2013 and SEBI guidelines to ensure transparency, fairness, and adherence to corporate governance norms. By following these regulations, companies can effectively utilize sweat equity shares as a means to align the interests of employees and stakeholders with the long-term goals and objectives of the company.

Disclaimer: This publication is not intended to cover all the aspects of those referred to herein and is only based on the understanding with respect to Sweat Equity Shares under the Companies Act, 2013 and SEBI Regulations. This publication has been prepared for information purposes only.

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