

# *An Analysis on the "Issue Of Sweat Equity Shares & ESOP"*

**navneet k. arora & co.**  
COMPANY SECRETARIES

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# *Proprietor 's Profile at a Glance*

## *Navneet K. Arora & Co., Company Secretaries*

### BASIC DETAILS

- ✂ Name of the Proprietor – **CS Navneet Arora**
- ✂ Year of Passing of ICSI Final Examination – **June 1990**
- ✂ Date of becoming Associate Member of ICSI (ACS - 8421) – **3<sup>rd</sup> March 1992**
- ✂ Date of becoming Fellow Member of ICSI (FCS - 3214) – **21<sup>st</sup> July 1997**
- ✂ Date of holding Certificate of Practice (CP - 3005) – **20<sup>th</sup> November 1998**
- ✂ Experience (No. of Years) – **25 Years (15 Years in Practice)**



### EDUCATIONAL QUALIFICATION:

- ✂ Master of Commerce.
- ✂ Fellow Member of The Institute of Company Secretaries of India
- ✂ Post Graduate Diploma in Financial Management

### PROFESSIONAL ASSOCIATION / RECOGNITION / MEMBERSHIP OF CONFEDERATION BODIES:

- ✂ Member - **All India Management Association New Delhi (AIMA).**
- ✂ Professional Member - **PHD Chamber of Commerce and Industries, New Delhi.**
- ✂ Appointed as **Peer Reviewer** by ICSI to conduct peer review of Practicing Member of ICSI.
- ✂ ICSI Certified participant of **National Workshop on Diligence Report for Banks.**
- ✂ **Convener South Delhi Study Group of NIRC of the ICSI** -2011, 2012, 2013 & 2014. Also Past Governing Body Member of Kanpur Chapter of NIRC of the ICSI & Past Member of various Professional Development Committee of NIRC of the ICSI.
- ✂ Regular Participant, Speaker of Seminars / Workshop on the Professional Development Program of various Professional Management Institutes including Institute of Company Secretaries of India (ICSI), Asia Pacific Institute of Management (AIM), National Foundation for Corporate Governance (NFCG) etc.

# *An overview of Issue of sweat equity shares*

- ❑ Sweat equity shares are equity shares issued by a company to its employees or directors at a discount, or as a consideration for providing know-how or a similar value to the company.
- ❑ it refers to equity shares given to the company's employees on favorable terms, in recognition of their work. The issue of sweat equity allows the company to retain the employees by rewarding them for their services.
- ❑ Sweat equity rewards the beneficiaries by giving them incentives in lieu of their contribution towards the development of the company. Further, it enables greater employee stake and interest in the growth of an organization as it encourages the employees to contribute more towards the company in which they feel they have a stake.
- ❑ The Company may issue sweat equity shares of a class of shares already issued if these conditions are duly met.
- ❑ The issue of sweat equity shares should be authorised by a special resolution passed by the Company in a general meeting The resolution should specify the number of shares, current market price, consideration, if any, and the section of directors /employees to whom they are to be issued As on the date of issue, a year should have elapsed since the company was entitled to commence business.

# ***Issue of sweat equity shares – Applicable Laws***

❖ **Extract of the relevant provisions prescribed in Section 54 of the Companies Act, 2013 as under:-**

**Section 54. (1)** Notwithstanding anything contained in section 53, a company may issue sweat equity shares of a class of shares already issued, if the following conditions are fulfilled, namely:—

- (a) the issue is authorised by a special resolution passed by the company;
- (b) 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;
- (c) not less than one year has, at the date of such issue, elapsed since the date on which the company had commenced business; and
- (d) 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.

**(2)** 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.

# ***Issue of sweat equity shares – Applicable Rules***

## **❖ Relevant Rules / Procedure in the Companies (Share Capital and Debentures) Rules, 2014 as under:-**

**(1)** A company other than a listed company, which is not required to comply with the Securities and Exchange Board of India Regulations on sweat equity, shall not issue sweat equity shares to its directors or employees at a discount or for consideration other than cash, for their providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called, unless the issue is authorised by a special resolution passed by the company in general meeting.

- 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.
- 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.

## ***Issue of sweat equity shares – Applicable Rules Contd.,***

(2) The explanatory statement to be annexed to the notice of the general meeting pursuant to section 102 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;
- (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;

## ***Issue of sweat equity shares – Applicable Rules Contd.,***

(l) a statement to the effect that the company shall conform to the applicable accounting standards; and

(m) diluted Earning Per Share pursuant to the issue of sweat equity shares , calculated in accordance with the applicable accounting standards.

**(3)** 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.

**(4)** 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:

Provided that 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.

**(5)** The 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 and the fact that the share certificates are under lock-in and the period of expiry of lock in shall be stamped in bold or mentioned in any other prominent manner on the share certificate.

**(6)** 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.



## ***Issue of sweat equity shares – Applicable Rules Contd.,***

**(7)** 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.

**(8)** A copy of gist along with critical elements of the valuation report obtained under clause (6) and clause (7) shall be sent to the shareholders with the notice of the general meeting.

**(9)** 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.

**(10)** 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, namely.-



## ***Issue of sweat equity shares – Applicable Rules Contd.,***

- (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.

**(11)** 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 sweat equity shares are not issued pursuant to acquisition of an asset.

**(12)** 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.

Explanation.- For the purposes of this sub-rule, it is hereby clarified that the Accounting value shall be the fair value of the sweat equity shares as determined by a registered valuer under sub-rule (6)

## ***Issue of sweat equity shares – Applicable Rules Contd.,***

**(13)** 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.

## ***Issue of sweat equity shares – Applicable Rules Contd.,***

- (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.
- (b) 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.
- (c) 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.

COMPANY SECRETARIES

## *An overview- Issue of Employee Stock Options*

- ❑ An Employee Stock Option Plan (ESOP) is a benefit plan for employees which makes them owners of stocks in the company. ESOPs have several features which make them unique compared to other employee benefit plans. Most companies, both at home and abroad, are utilizing this scheme as an essential tool to reward and retain their employees. Currently, this form of restructuring is most prevalent in IT companies where manpower is the main asset.
- ❑ A stock option granted to specified employees of a company. ESOs carry the right, but not the obligation, to buy a certain amount of shares in the company at a predetermined price. An employee stock option is slightly different from a regular exchange-traded option because it is not generally traded on an exchange, and there is no put component. Furthermore, employees typically must wait a specified vesting period before being allowed to exercise the option.

# ***Issue of Employee Stock Options – Applicable laws***

❖ **Extract of the relevant provisions prescribed in Section 62 of the Companies Act, 2013 as under:-**

**Section 62. (1)** Where 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—

(a) to persons who, at the date of the offer, are holders of equity shares of the company in proportion, as nearly as circumstances admit, to the paid-up share capital on those shares by sending a letter of offer subject to the following conditions, namely:—

(i) the offer shall be made by notice specifying the number of shares offered and limiting a time not being less than fifteen days and not exceeding thirty days from the date of the offer within which the offer, if not accepted, shall be deemed to have been declined;

(ii) unless the articles of the company otherwise provide, the offer aforesaid shall be deemed to include a right exercisable by the person concerned to renounce the shares offered to him or any of them in favour of any other person; and the notice referred to in clause (i) shall contain a statement of this right;

(iii) after the expiry of the time specified in the notice aforesaid, or on receipt of earlier intimation from the person to whom such notice is given that he declines to accept the shares offered, the Board of Directors may dispose of them in such manner which is not dis-advantageous to the shareholders and the company;

## ***Issue of Employee Stock Options- Applicable Laws Contd.,***

(b) to employees under a scheme of employees' stock option, subject to special resolution passed by company and subject to such conditions as may be prescribed; or

(c) to any persons, if it is authorised by a special resolution, whether or not those persons include the persons referred to in clause (a) or clause (b), either for cash or for a consideration other than cash, if the price of such shares is determined by the valuation report of a registered valuer subject to such conditions as may be prescribed.

(2) The notice referred to in sub-clause (i) of clause (a) of sub-section (1) shall be dispatched through registered post or speed post or through electronic mode to all the existing shareholders at least three days before the opening of the issue.

(3) Nothing in this section shall apply to the increase of the subscribed capital of a company caused by the exercise of an option as a term attached to the debentures issued or loan raised by the company to convert such debentures or loans into shares in the company:

Provided that the terms of issue of such debentures or loan containing such an option have been approved before the issue of such debentures or the raising of loan by a special resolution passed by the company in general meeting.

(4) Notwithstanding anything contained in sub-section (3), where any debentures have been issued, or loan has been obtained from any Government by a company, and if that Government considers it necessary in the public interest so to do, it may, by order, direct that such debentures or loans or any part thereof shall be converted into shares in the company on such

## ***Issue of Employee Stock Options- Applicable Laws Contd.,***

terms and conditions as appear to the Government to be reasonable in the circumstances of the case even if terms of the issue of such debentures or the raising of such loans do not include a term for providing for an option for such conversion:

Provided that where the terms and conditions of such conversion are not acceptable to the company, it may, within sixty days from the date of communication of such order, appeal to the Tribunal which shall after hearing the company and the Government pass such order as it deems fit.

(5) In determining the terms and conditions of conversion under sub-section (4), the Government shall have due regard to the financial position of the company, the terms of issue of debentures or loans, as the case may be, the rate of interest payable on such debentures or loans and such other matters as it may consider necessary.

(6) Where the Government has, by an order made under sub-section (4), directed that any debenture or loan or any part thereof shall be converted into shares in a company and where no appeal has been preferred to the Tribunal under sub-section (4) or where such appeal has been dismissed, the memorandum of such company shall, where such order has the effect of increasing the authorized share capital of the company, stand altered and the authorized share capital of such company shall stand increased by an amount equal to the amount of the value of shares which such debentures or loans or part thereof has been converted into.



# ***Issue of Employee Stock Options- Applicable Rules***

## **❖ Relevant Rules / Procedure in the Companies (Share Capital and Debentures) Rules, 2014 as under:-**

A Company, other than a listed company, which is not required to comply with Securities and Exchange Board of India Employee Stock Option Scheme Guidelines shall not offer shares to its employees under a scheme of employees' stock option (hereinafter referred to as "Employees Stock Option Scheme"), unless it complies with the following requirements, namely:-

**(1)** the issue of Employees Stock Option Scheme has been approved by the shareholders of the company by passing a special resolution.

**Employee means:-** (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.

## ***Issue of Employee Stock Options- Applicable Rules Contd.,***

**(2)** The Company shall make the following disclosures in the explanatory statement annexed to the notice for passing of the resolution-

- (a) the 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 maximum number of options to be granted per employee and in aggregate;
- (j) the method which the company shall use to value its options;
- (k) the conditions under which option vested in employees may lapse e.g. in case of termination of employment for misconduct;
- (l) the specified time period within which the employee shall exercise the vested options in the event of a proposed termination of employment or resignation of employee; and
- (m) a statement to the effect that the company shall comply with the applicable accounting standards .

## ***Issue of Employee Stock Options – Applicable Rules Contd.,***

**(3)** 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.

**(4)** The approval of shareholders by way of separate resolution shall be obtained by the company in case of-

(a) grant of option to employees of subsidiary or holding company; or

(b) grant of option to identified employees, during any one year, equal to or exceeding one percent of the issued capital (excluding outstanding warrants and conversions) of the company at the time of grant of option.

**(5)(a)** 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) The notice for passing special resolution for variation of terms of Employees Stock Option Scheme shall disclose full of the variation, the rationale therefor, and the details of the employees who are beneficiaries of such variation.

**(6)(a)** There shall be a minimum period of one year between the grant of options and vesting of option:

## ***Issue of Employee Stock Options – Applicable Rules Contd.,***

Provided that in a case where options are granted by a company under its Employees Stock Option Scheme in lieu of options held by the same person under an Employees Stock Option Scheme in another company, which has merged or amalgamated with the first mentioned company, the period during which the options granted by the merging or amalgamating company were held by him shall be adjusted against the minimum vesting period required under this clause;

(b) The company shall have the freedom to specify the lock-in period for the shares issued pursuant to exercise of option.

(c) 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.

**(7)** 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.

**(8)(a)** The option granted to employees shall not be transferable to any other person.

## ***Issue of Employee Stock Options – Applicable Rules Contd.,***

(b) The option granted to the employees shall not be pledged, hypothecated, mortgaged or otherwise encumbered or alienated in any other manner.

(c) Subject to clause (d), no person other than the employees to whom the option is granted shall be entitled to exercise the option.

(d) 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.

(e) 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.

(f) In the event of resignation or termination of employment, all options not vested in the employee as on that day shall expire. However, the employee can exercise the options granted to him which are vested within the period specified in this behalf, subject to the terms and conditions under the scheme granting such options as approved by the Board.

**(9)** The Board of directors, shall, inter alia, disclose in the Directors' Report for the year, the following details of the Employees Stock Option Scheme:

(a) options granted;

(b) options vested;

(c) options exercised;

(d) the total number of shares arising as a result of exercise of option;

(e) options lapsed;

(f) the exercise price;

## ***Issue of Employee Stock Options – Applicable Rules Contd.,***

- (g) variation of terms of options;
  - (h) money realized by exercise of options;
  - (i) total number of options in force;
  - (j) employee wise details of options granted to;-
  - (i) key managerial personnel;
  - (ii) any other employee who receives a grant of options in any one year of option amounting to five percent or more of options granted during that year.
  - (iii) identified employees who were granted option, during any one year, equal to or exceeding one percent of the issued capital (excluding outstanding warrants and conversions) of the company at the time of grant;
- (10)** (a) The company shall maintain a Register of Employee Stock Options in **Form No. SH.6** and shall forthwith enter therein the particulars of option granted under clause (b) of sub-section (1) of section 62.
- (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.
- (c) 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.
- (11)** Where the equity shares of the company are listed on a recognized stock exchange, the Employees Stock Option Scheme shall be issued, in accordance with the regulations made by the Securities and Exchange Board of India in this behalf.

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**navneet k. arora & co.**  
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