



## SEBI (Issue of Sweat Equity) Regulations

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JK SHAH CLASSES

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- ✓ Sweat equity shares refers to equity shares given to the company's employees on favourable terms, in recognition of their work. Sweat equity shares is one of the modes of making share based payments to employees of the company. The issue of sweat equity shares allows the company to retain the employees by rewarding them for their services.
  - ✓ Sweat equity shares rewards the beneficiaries by giving them incentives in lieu of their contribution towards the development of the company.
  - ✓ Further, Sweat equity shares 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

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Section 2 (88) of the Companies Act, 2013 defines “sweat equity shares” which 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.

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Company issue shares at a discount or for consideration other than cash to selected employees and directors as per norms approved by the Board of Directors or any committee, like compensation committee, formed for this purpose.

This is based on the know how provided or intellectual property rights created and given for value additions made by such directors and employees to the company.

It may be noted that the intellectual property right, know how or value additions arise as of now mainly in the case of Information Technology related companies and Pharmaceutical companies. Categories of industries which are eligible to issue sweat equity shares have not been indicated by the Government either in the Act or otherwise.



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According to Section 54 of the Companies Act, 2013 a company may issue sweat equity shares of a class of shares already issued, if the following conditions are fulfilled:

- (a) The issue is authorized by a special resolution passed by the company in the general meeting.
- (b) The resolution specifies the number of shares, 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) The sweat equity shares of a company whose equity shares are listed on a recognized stock exchange are issued in accordance with the regulations made by SEBI in this regard and if they are not listed the sweat equity shares are to be issued in accordance with the rule 8 of Companies (Share Capital and Debenture) Rules, 2014

# Whether Issue of sweat equity shares can be in the form of preferential Issue?

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- Issue of Sweat Equity Shares is not a 'preferential issue' 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.
- It clearly excludes issue of sweat equity shares from the definition of preferential offer

Applicability

Listed companies which are issuing sweat equity shares are required to comply with SEBI (Issue of Sweat Equity) Regulations, 2002.

Non- Applicability

These regulations shall not apply to an unlisted company. However, unlisted company coming out with initial public offering and seeking listing of its securities on the stock exchange, pursuant to issue of sweat equity shares, shall comply with the SEBI (ICDR) Regulations, 2009.



# SWEAT EQUITY SHARES MAY BE ISSUED TO EMPLOYEE AND DIRECTORS

A company whose equity shares are listed on a recognized stock exchange may issue sweat equity shares in accordance with Section 54 of Companies Act, 2013 and these Regulations to its



Employees



Directors

# SPECIAL RESOLUTION

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- a) The total number of shares to be issued as sweat equity.
- b) The current market price of the shares of the company.
- c) The value of the intellectual property rights or technical know how or other value addition to be received from the employee or director along with the valuation report / basis of valuation.
- d) The names of the employees or directors or promoters to whom the sweat equity shares shall be issued and their relationship with the company.

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- e) The consideration to be paid for the sweat equity. f) The price at which the sweat equity shares shall be issued.
- g) Ceiling on managerial remuneration, if any, which will be affected by issuance of such sweat equity.
- h) A statement to the effect that the company shall conform to the accounting policies as specified by SEBI.
- i) Diluted Earning Per Share pursuant to the issue of securities to be calculated in accordance with International Accounting Standards / standards specified by the Institute of Chartered Accountants of India.

# ISSUE OF SWEAT EQUITY SHARES TO PROMOTERS



Issue of sweat equity shares to promoters, the same shall also be approved by **simple majority** of the shareholders in **General Meeting**.



The promoters to whom such Sweat Equity Shares are proposed to be issued ***shall not participate*** in such resolution and separate resolution shall be passed for each transaction of issue of Sweat Equity. Such resolution shall be valid for a period of ***not more than twelve months*** from the date of passing of the resolution. For the purposes of passing the resolution, the explanatory statement shall contain the disclosures as specified in the Act

# PRICING OF SWEAT EQUITY SHARES

The price of sweat equity shares shall not be less than the higher of the following:

The average of the weekly high and low of the closing prices of the related equity shares during last six months preceding the relevant date; or

The average of the weekly high and low of the closing prices of the related equity shares during the two weeks preceding the relevant date.

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If the shares are listed on more than one stock exchange, but quoted only on one stock exchange on given date, then the price on the stock exchange shall be considered.

If the share price is quoted on more than one stock exchange, then the stock exchange where there is highest trading volume during that date shall be considered.

If the shares are not quoted on the given date, then the share price on the next trading day shall be considered.

“Relevant date” for this purpose means the date which is thirty days prior to the date on which the meeting of the General Body of the shareholders is convened, in terms of clause (a) of sub section (1) of section 54 of the Companies Act, 2013.

# VALUATION OF INTELLECTUAL PROPERTY

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The valuation of the intellectual property rights shall be carried out by a merchant banker

- The merchant banker may consult such experts and valuers, as he may deem fit having regard to the nature of the industry and the nature of the property or other value addition.
- The merchant banker shall obtain a certificate from an independent Chartered Accountant that the valuation of the intellectual property or other value addition is in accordance with the relevant accounting standards

# ACCOUNTING TREATMENT

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Where the sweat equity shares are issued for a non-cash consideration, such non cash consideration shall be treated in the following manner in the books of account of the company:

1.

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 relevant accounting standards; or

2.

where the above clause is not applicable, it shall be expensed as provided in the relevant accounting standards.



## LOCK-IN



The Sweat Equity shares shall be locked in for a period of **three years** from the date of allotment.

# PLACING OF AUDITORS BEFORE ANNUAL GENERAL MEETING

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In the General meeting subsequent to the issue of sweat equity, the Board of Directors shall place before the shareholders, a certificate from the auditors of the company that the issue of sweat equity shares has been made in accordance with the Regulations and in accordance with the resolution passed by the company authorizing the issue of such Sweat Equity Shares

