March, 2021

Edition I

ISSUANCE OF BONUS SHARES

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1.1 INTRODUCTION

Definition:
Bonus shares are additional shares which are given to the existing shareholders without any cost, i.e. shareholders are not required to pay any money to subscribe to the new (bonus) shares, offered to them. The number of shares owned by a shareholder is the basic criteria in issuing the bonus shares. Company generally issues these shares out of accumulated profit(s) which are not given in the form of dividend.

Rationale:
The reason behind issuing shares has two perspectives, one for company and another for shareholders:

Company:

- A company might not have sufficient cash to distribute due to shortage of funds despite earning well, in such cases issuing bonus shares is a best way to boost shareholder's confidence and trust,

- Companies are not required to deduct any tax, on or before, allotting bonus shares, unlike withholding tax (TDS) which to be deducted by company, in case of dividend.

- Companies issue bonus shares to support retail participation and expand their shareholder base. When cost per share of an organization is high, it gets to be troublesome for new investors' to buy shares of that company. Share price of company's share will fall in the same proportion as the bonus shares are issued, leading to more participation by the retail investors. It shall be noted that, a bonus issue only increases the number of shares, the Net Worth of the organisation remains the same and there is no dilution in the percentage holding of existing shareholders

Shareholder:

- More dividend(s) in the future,

- No outflow of capital by the shareholder,

- More number of shares thus more voting power, *vis a vis* new investors,

- Beneficial for shareholders' looking for long term investment.

Basis of issuance of bonus shares to shareholders:
As mentioned before, bonus shares are given only to existing shareholders' (holding shares as on the cut-off date) For example, if Investor A holds 200 shares, and the company announced one for two bonus shares of the company, this would imply the shareholder will get one bonus shares for two shares held, without any consideration to be paid by them.

What is cut-off date?
Also known as record date which is set by the company, before announcing the issuance of bonus shares to existing shareholders. If a person holds shares as on the cut-off date then he may be eligible for receiving the bonus shares. It is set by the company to find the qualified shareholders'.

Before announcing issuance of bonus shares it also becomes mandatory on the part of company to declare a book closure date, which is a period in which the company will not make any adjustments to the register of shareholders' or entertain any request for transfer of shares. Companies use the book closure date to identify the cut-off date.

1.2 RELEVANT PROVISIONS

1. (Unlisted Company)

Companies Act, 2013

Section 63 of the Companies Act, 2013 prescribes the following requirements for issuance of Bonus Shares:

(1) A company may issue fully paid-up bonus shares to its members, in any manner whatsoever, out of-

- Its free reserves;
- The securities premium account; or
- The capital redemption reserve account.

Provided that no issue of bonus shares shall be made by capitalising reserves created by the revaluation of assets.

(2) No company shall capitalise its profits or reserves for the purpose of issuing fully paid-up bonus shares under sub-section (1), unless-

- It is authorised by its articles;
- It has, on the recommendation of the board, been authorised in the general meeting of the company;
- It has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it;
- It has not defaulted in respect of the payment of statutory dues of the employees such as, contribution to provident fund, gratuity and bonus;
- The partly paid-up shares, if any outstanding on the date of allotment, are made fully paid-up;
- The company which has once announced the decision of its Board recommending a bonus issue shall not subsequently withdraw the same (Rule 14 of the Companies (Share Capital and Debentures) Rules, 2014).

(3) The bonus shares shall not be issued in lieu of dividend.

2. (Listed Company)

In addition to the requirements prescribed under Companies Act, 2013, a Listed Company is required to comply with the conditions prescribed under Chapter XI of Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018:

i. None of the promoters or directors is a fugitive economic offender,

ii. An issuer shall make a bonus issue of equity shares only if it has made reservation of equity shares of the same class in favour of the holders of outstanding compulsorily convertible debt instruments if any, in proportion to the convertible part thereof,

iii. The equity shares so reserved for the holders of fully or partly compulsorily convertible debt instruments, shall be issued to the holder of such convertible debt instruments or warrants at the time of conversion of such convertible debt instruments, optionally convertible instruments,

iv. If a company has issued SR equity shares (superior voting rights) to its promoters or founders, any bonus issue on the SR equity shares shall carry the same ratio of voting rights compared to ordinary shares and the SR equity shares issued in a bonus issue shall also be converted to equity shares having voting rights same as that of ordinary equity shares along with existing SR equity shares.

v. A company, announcing a bonus issue after approval by its board of directors and not requiring shareholders' approval for capitalisation of profits or reserves for making the bonus issue, shall implement (the date of commencement of trading) the bonus issue within fifteen days from the date of approval of the issue by its board of directors. Where shareholders' approval is required for capitalisation of reserves or profits, the bonus issue shall be implemented within 2 months from the meeting of the board of directors'.

1.3 BONUS SHARES OR DIVIDEND

When a company have surplus reserves and the Board of Directors plan to give the benefit of the same to the shareholders, then the Board of Directors have two options:

1. To distribute such reserves to the Shareholders in the form of dividend,
2. To capitalize such reserves by issuing Bonus Shares.

The decision to give dividend or bonus issue can depend on various factors such as amount of reserve available, form of payment, taxability etc. Following points are considered by the company before issuance of bonus shares or payment of dividend:

1. The Dividend is paid out of free reserves or profits of the company, whereas the bonus shares are issued out of free reserves, Securities premium A/c or Capital Redemption Reserve A/c.

2. Dividend can only be paid in the form of cash, whilst bonus shares are equity shares which are credited in the demat account of the shareholders'.

3. Payment of dividend by the company doesn't impact the paid up capital on the balance sheet of the company, however subsequent to the issuance of bonus shares the paid up capital of the company increases by the same proportion as number of bonus shares are issued.

4. Prior to 31st March, 2020, every company was required to deduct Dividend Distribution Tax before payment of dividend to the shareholders'. However, the Finance Act, 2020, has amended the section 115-O of the Income Tax, 1961, which is effective from 1st April, 2021, which species that companies are not required to pay any Dividend Distribution Tax. On the other hand, when bonus shares are issued by the company, no tax has to be paid by the company.

5. When dividend is received by the shareholder, the dividend is the taxable income in the hands of the shareholder and they have to pay

the tax (on it) at the applicable tax rates. Whereas, if the bonus shares are issued by the company, then the shareholder will pay the Short Term Capital Gain tax (STCG) or Long Term Capital Gain tax (LTCG), as the case may be, at the time of sale of shares.

1.4 TAXABILITY

One of the important aspects that every company needs to consider is taxation. Every company coming up with any bonus issue must analyze the when and in whose hands, the transaction will be taxable.

The bonus shares are issued to shareholder without any consideration so there will be no tax in the hands of shareholder at the time of issue of bonus shares. The tax implication will come at the time when shares are sold by them and the consideration shall be taxable in the hands of shareholder, as the cost of acquisition of bonus shares is NIL.

1.5 EFFECT OF BONUS ISSUE FROM COMPANY POINT OF VIEW

Bonus shares do not directly affect a company's performance. Bonus issue has following major effects.

1. Share value of the company increase pursuant to the issue of bonus shares,
2. Liquidity in the stock increases,
3. Effective Earnings per share, Book Value per share and other per share ratios stand reduced,
4. Stock Market act in a favourable manner,
5. Accumulated profits are reduced,
6. Bonus issue has a positive effect on the market, which portrays as a sign of good health of the company,
7. Conserve cash for reinvesting back into the business.

1.6 CERTAIN CHECKS TO BE DONE AFTER ISSUE OF SHARES

1. There should be sufficient authorised capital for issue of such bonus shares,
2. The Articles of Association of the Company should permit such issuance of bonus shares,
3. Whether the Company have sufficient balance in free reserves, securities premium and capital redemption reserve for issue of bonus shares,
4. The Company has not made any default in payment of interest or principal in respect of fixed deposit or debt securities issued by it,
5. The Company has not defaulted in payment of statutory dues of the employees, such as, contribution to provident fund, gratuity and bonus,
6. All the partly paid shares outstanding at the date of allotment, are made fully paid-up,
7. None of the promoters or directors is a fugitive economic offender (Applicable in case of listed entity)

1.7 PROCEDURE FOR ISSUANCE OF BONUS SHARES

1. Convening of Board Meeting by issuing 7 (Seven) days' notice to the Board of Directors,

2. Hold the Board Meeting and pass Board resolution for issue of bonus shares and approve notice of Extra Ordinary General Meeting (EGM)/Annual General Meeting (AGM), as the case may be,

3. File MGT-14 with the Registrar within 30 days of passing of Resolution in the Board Meeting,

4. Issue of Notice of EGM/AGM in writing to all the Members, Director and Statutory auditors of the company by giving not less than clear 21 days notice,

5. Convene the EGM/AGM and pass ordinary resolution for issue of bonus shares,

6. Convene another Board Meeting by issuing 7 (Seven) days' notice to Board of Directors,

7. Hold the Board Meeting and pass necessary resolution for allotment of bonus shares,

8. File eForm Pas-3 with Registrar within 30 days of passing resolution in Board Meeting,

9. The company shall intimate the depository regarding the details of allotment of securities, immediately on allotment. Also, pay the appropriate stamp duty on issuance of new equity shares to the Depository along with the Corporate Action Form (applicable only in case of listed company and unlisted public company),

10. In case of Private Company, issue share certificates in Form SH.1 to the shareholders within 2 months from the allotment and pay the applicable stamp duty,

11. The particulars of every share certificate issued shall be entered in the Register of Members in Form MGT 1.

CONCLUSION

The major objective (in case of listed entity) behind issuance of bonus shares is to increase the retail participation, as sometimes cost of a share becomes high due to which they are thinly traded. The issuance of bonus shares allows a company to reduce the market price of such share, thereby increasing the shareholding base. It also gives comfort from financial planning point of view, as it does not involve any cash distribution to the shareholders (dividend). It further involves increase in capital base, however there is no change in the net worth of the company. Therefore, it is a win-win situation for the company as well its shareholders'. Listed companies frequently use this route, keeping in their mind overall strategy, while aiming for reducing the price of per shares in order to increase the retail participation.

CONTACT US

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