

Issue of Bonus Shares (Sec 63)

1. Meaning of Bonus shares

As per dictionary ‘Bonus’ means “additional payment to employees as a means of increasing output” or in another meaning “anything that makes one feel encouraged”. Probably the first meaning does not suit in the contest of the bonus shares. However another meaning somehow seems to be true, the act of the board of directors in considering the bonus issue may encourage the shareholders especially in case of listed company. The price of stock of the company may be bullish after announcing the bonus shares.

The bonus shares are called with different names across the globe, at England it called as “plough-shares” or “capitalisation issues”. In USA Bonus shares are called as stock dividend. The word ‘bonus’ is itself misleading and totally different from the sense.

It is now settled law that a bonus issued in the form of fully paid shares of the company is not income for income-tax purposes. In Commissioner of Inland Revenue v. John Blott 8 T.C. 101 the assessee, who was a share-holder in a limited company, obtained in satisfaction of bonus declared out of company’s undivided profits, certain shares.

The share-holders had no option to receive cash in lieu of shares in satisfaction of the bonus. The House of Lords by a majority decision (two of the Law Lords dissenting) held that the shares credited to the assessee in respect of the bonus, being distributed by the company as capital, were not income in the hands of the respondent taxable to income-tax or super-tax. The observations of Viscount Haldane appropriately described the process of the issue of bonus shares. At page 125, the learned Law Lord states:

A shareholder is not entitled to claim that the company should apply its undivided profits in payment to him of dividend. Whether it must do so or not is a matter of internal management to be decided by the majority of the shareholders. He cannot sue for such a dividend until he has been given a special title by its declaration. But if, acting within its powers, it disposes of these profits by converting them into capital instead of paying them over to the shareholder, that, as I conceive it, is conclusive as against all the outside world, including the Crown, and the form of the benefit which the shareholder receives from the money in the hands of the company is one which is for determination by the company alone.

The accumulated profits which are undistributed after paying necessary taxes are the property of the company. This may be used by the company for distribution as dividends to the shareholders. However, as a sound financing policy the company can plough back the

said accumulated profits. This is called reinvestment of internal accruals for the finance needs of the company. This measure may be some times temporary in nature. After some time in order to build confidence in the equity shareholders and based on the financial position, the company may pay dividend from accumulated profits. However as a permanent measure the company can also convert the accumulated profits, capital reserves (other than asset revaluation reserves), revenue and general reserve (These may also be called accumulated surplus) including security premium account, into share capital by issuing fully paid-up bonus shares. This is how bonus shares comes into existence.

Bonus shares are distributed at free of charge. However receipt of bonus shares is not a gift or income in the hands of the shareholders. Accordingly receipt of bonus shares is not taxable income under the Income Tax. (In Re. Commissioner of Income Tax, Madras v AAV Ramachandra Chettiar (1964)1 Mad LJ 281.) Shareholders are Bonus shares are shares issued by converting the surplus into capital and divided among the members in proportion to their existing shareholding. Bonus shares are generally issued at times when the company is in the state of prosperous with huge accumulated surplus. As per section 52 of the Act, securities premium account can be used for the issue of fully paid-up bonus shares.

2. Effect of Issue of Bonus Shares:

Gower in his book, 'Modern Company Law ' however, observes as follows at page 104:

This operation can be undertaken by means of a 'bonus issue', that is, by issuing mere shares to the existing holders and using the funds available for dividend but retained by the company to pay for them. By this means the reserves on share premium account, or some part of them, are capitalised or converted into share capital. The only result, from the shareholder's point of view is that his proportion of the capital of the business is now represented by a greater number of shares, each of which is therefore worth less and this may make them more readily marketable.

Once bonus shares are issued the value of share will come down. To know the value prior to issue of bonus shares the net-worth of the company is divided into less numbers of the share, hence the value of share would be more. After issue of the bonus shares the number of shares issued by the company would be more. To know the value of share the net-worth of the company would be divided by the large number of shares consequently the value of the share would come down from value of share was there before issue of bonus shares. In case of listed company, the bonus issue will also impact adversely on the market price as well.

It is not possible to say with any certainty that the value of the bonus shares is really equivalent to the value of the original shares on the date of issue. The issue of bonus shares themselves bring about an uncertainty in the value of the shares. The state of affairs at the time of the issue is that the company has in circulation only the original shares. The fresh issues in the shape of bonus shares would of course have a tilting effect on the equilibrium of the value of the shares of the company in general. For example, let us take the following illustration. The share capital of a company is Rs.1,00,00,000 divided into 10,00,000 equity shares 10 rupee each. The accumulated profit available for declaration of dividend amount

to Rs.1,00,00,000 the share will be worth each Rs. 20. If bonus shares are issued at par the share capital will be increased to Rs.2,00,00,000 but there will be corresponding increase of shares to 20,00,000 from 10,00,000. Each share will be worth rupee ten but each shareholder will be having 100 percent more shares. The shareholder gains nothing. He gets more shares but the pecuniary advantage is nil.

3. Matching resource deployment

Cash resources of the company may not be enough to pay regular cash dividend. By issuing the bonus shares the company wishes to increase cash liquidity to meet the expansion or to repay any loan or any liability. In order to bring its paid-up capital more in line with the capital resources deployed in the system, the company may consider the issue of bonus.

4. Issue of bonus shares at a Premium

Internal resources like accumulated profits/ capital redemption reserves, premium account etc are capitalised by issuing bonus shares to existing shareholders of the company. In general the premium is extra money than the face value of shares collected from proposed allottees for issue of shares. It is similar to goodwill in case of a partnership. However treatment to goodwill in the books of the partnership firm is different from that of premium collected by the company. In case of issue of bonus shares, there is no inflow of cash or consideration other than cash into the company. As there is no inflow of money or money's worth, the concept of premium does not exist for issue of bonus shares.

5. Advantages of Bonus issue

- (i) It will enable the company to retain more money permanently to meet the business requirements. The reserves, once capitalised, can be used without any restriction.
- (ii) There will be more shares available at market for trading.
- (iii) The value of shares at market would be declined to a figure close to their nominal value by a bonus issue. This lowers the investment threshold and helps in bringing new investors to the Company.
- (iv) The shareholder may expect a marginal increase in market value of a share.

6. Conditions to issue Bonus shares

The company can issue bonus shares from unissued capital by using the free reserves or security premium account or the capital redemption reserve account. However now it is settled law. No bonus shares can be issued by capitalizing reserves created by the revaluation of assets.

7. Provision in Articles of Association

Issue of bonus share should be authorised by an article at articles of the Company. However if the company has adopted the Table F, by relaying regulation 39 and 40 the company can issue the bonus issue. In case the company has not adopted the table F and there is no specific provision in its articles then, it should amend its articles suitably before issuing the bonus shares.

8. Recommendation by Board

The issue of bonus share, first it should be recommended by the board of directors thereafter it should be approved by the shareholders by passing an ordinary resolution.

9. Default v Default Remedied

In the absence of definition 'default' in the Companies Act, 2013, it is very difficult to draw a conclusion that whether default committed but subsequently remedied will also debar the company from issue of bonus shares permanently. Default could be anything like delay in making payment of interest or payment of PF, superannuation amount etc. The legislative intention must be to restrain not to prohibit the company from issuing bonus shares, if any default under clause (c) and (d) of sub-section (2) subsists on date of issue of bonus shares. Once default is made good/remedied, the company should be in position to go ahead with proposal of bonus shares. In the absence of a similar proviso in this section that is found place at clause (c) of (1) of prohibitory section 70 in case of buy back, the company need not wait for any period. Once default is remedied, the default has ceased to subsist. The company can proceed with issue of bonus shares.

There should not be any default in payment of interest or principal in respect to fixed deposits or debt securities issued by it. It sounds that here the expression 'debt securities' does not include the general loans and advances taken by the company. Debt securities issued by the company must be convertible or non-convertible debentures or such other equivalent instruments in nature of securities. However the company can issue bonus shares even it defaulted in payment of interest or principal in respect of secured or unsecured loans. This must be a leeway to the company to convert accumulated profits to into bonus shares in such situation as there is no cash out flow, the bank and financial institutions would not face any threat to their loan. Further this leeway will enable the management as part of commitment given to banks and financial institutions to increase the paid-up of the company either to maintain the debt equity ratio or withhold the accumulated profits permanently in the event of given situation.

In case the company has defaulted in respect of the repayment of statutory dues of its employees such as contribution to provident fund, gratuity and bonus, the company can't issue the bonus shares. It would be reason that employees being one of stakeholders before distribute anything among the owners should ensure that the statutory dues of the employees are promptly paid. However, this section does not speak about the default in payment of regular wages and salaries to employees.

11. Keeping certain portion in Abeyance

As per section 126 of the Act, wherever the company receives any duly executed share transfer form which is pending for registration as on recorded date or such other practical date considered for issue of bonus shares, the company is required to keep in abeyance such portion of bonus shares pertaining to shares which are in subject matter of transfer and allot the shares in favour of transferee only after registration of share transfers.

13. Restriction on Listed Companies

To issue bonus shares the listed companies are required to comply with additional conditions and restrictions as imposed by SEBI through various regulations. SEBI ICDR 2009 imposed the following additional restrictions:

- (i) The listed company should reserve portion of bonus shares to the outstanding compulsorily convertible debt instruments in proportion to their convertibility.
- (ii) The said reserved portion of bonus shares should be issued at time of conversion along with resulting equity shares.
- (iii) The bonus shares should be issued out of free reserves created out genuine profits or securities premium collected in cash. As restricted by the section, these regulations also prohibit issue of bonus shares from reserves created by revaluation of fixed assets.

Further it seems within the securities premium account, only such premium collected in cash is allowed to use for issue of bonus shares. However section allows all types of premium including premium arisen from issue of sweat equity or consideration other than cash etc.

Where approval of shareholders is not required to issue the bonus shares, the issue of bonus should be completed within 15 days from the date of approval of the board.

In case approval of shareholders is required, the issue of bonus shares should subject to approval of shareholder be completed within 2 months from the date of approval of the board.

14. Requirement of FEMA

As per the master circular dated 01-07-2015 on Foreign Direct Investment in India issued by RBI under sub-section (3) of Section 6 of the Foreign Exchange Management Act, 1999 read with Notification No. FEMA 20/2000-RB dated May 3, 2000 amended from time to time, the company issuing bonus shares to existing non-resident shareholders is required to comply with the sectoral cap, reporting requirements. However, bonus shares can be issued to erstwhile OCBs without prior approval of the Reserve Bank, provided that the Overseas Corporate Bodies (erstwhile concept prior to 2003) is not in the adverse list of RBI.

15. Offence and Compoundability

This section does not prescribe any penal provision for contravention of the section. However section 450 of the Act will be applicable. Accordingly, the punishment for contravention, the company and every officer of the company who is in default shall be punishable with a fine upto Rs.10,000, if the contravention continues then the fine shall be Rs. 1,000 every day. The offenses under this section are compoundable under section 441 of the Act.

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