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Allocation Of Shares for Non – Cash Consideration

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ABSTRACT
The allocation of shares in exchange for non-cash assets, such as intellectual property, real estate, or services, is a common transaction in the business world. This practise offers businesses a means to raise capital, expand operations, or acquire valuable assets without depleting their cash reserves. However, this seemingly straightforward exchange is subject to various legal and regulatory requirements that must be adhered to. In this article, we will explore the process of allotting shares for non-cash consideration and the key legal considerations associated with this practice. First and foremost, it is important to conduct a thorough valuation of the non-cash assets being exchanged for shares. The valuation process should be conducted by a qualified third-party expert to ensure that the exchange is fair and equitable for all parties involved. Additionally, it is crucial to document the valuation process and maintain clear records to demonstrate compliance with regulatory requirements. regulatory complexities that demand careful consideration. This essay begins by examining the fundamental principles underlying the allocation of shares for non-cash consideration, highlighting its importance in contemporary corporate finance. It then navigates through the legal landscape, discussing the relevant statutory provisions, regulatory oversight, and judicial precedents that shape this practice. Special attention is given to issues such as valuation, disclosure requirements, and shareholder rights, which are critical in ensuring transparency and fairness. To provide a comprehensive perspective, international comparisons are drawn to illustrate how different jurisdictions approach the allocation of shares for non-cash consideration. This cross-jurisdictional analysis sheds light on best practises and emerging trends in this field, offering valuable insights for legal practitioners, corporate executives, and policymakers.

Keywords: Shares, Companies Act, Consideration, Non-Cash

Introduction

Employees contributing to an organisation being remunerated through shares is not a new concept (Sogani & Nagashayana, 2011). It originated in the Silicon Valley of the USA, where technology startups began offering company shares as a form of remuneration or reward to attract high-quality resources and services. Shares allotted for non-cash consideration are an alternative form of compensation that companies can offer to employees. This practise involves issuing shares to individuals or entities in exchange for assets, services, or other non-monetary contributions. This alternative form of compensation allows companies to leverage the value of non-cash resources and incentivize employees or stakeholders in a unique way. Companies may choose to use the allotment of shares for non-cash considerations for various reasons. In the USA's Silicon Valley, technology startups started offering company shares as remuneration or rewards to attract top-quality resources and services from employees. This alternative compensation practise

involves issuing shares in exchange for non-monetary contributions, allowing companies to leverage non-cash resources uniquely. This practise has gained popularity due to its potential benefits for both companies and employees. Companies that allocate shares for non-cash consideration can attract and retain talented employees by providing them with a stake in the company's success.

Legal Position of Non-Cash Consideration

In India, the 1956 Companies Act spoke about the allotment of shares for non-cash consideration and defined the rules and regulations surrounding such transactions under Section 75 of the Act. The section explicitly mentions allotting shares for contracts of service or for contracts of sale. It specifies that such contracts duly stamped have to be produced to the registrar along with the number of shares allotted and to what extent the amount is being treated as paid up for the allotted share. Additionally, the Companies Act of 2013 further clarifies the requirements for the allotment of shares for non-cash consideration. Rule 12 of the Companies (Prospectus and Allotment of Securities) Rules, 2014, specifies that a PAS-3 form must be submitted to the Registrar of Companies within 30 days of the allotment, providing details such as the nature of non-cash consideration. Rule 12(4) requires a valuation report to be prepared by a registered valuer for the non-cash consideration being allotted. This report serves as evidence of the fair valuation of the non-cash assets or services being exchanged for shares. Allotment of shares for non-cash consideration, though not specifically spoken about in the 2013 Act, follows suit from the 1956 Act, while the Rules following the 2013 Act provide guidance and requirements for such transactions. Nevertheless, such allotments are accepted in the case of sweat equity shares and preferential shares being dealt in the Companies (Share Capital and Debentures) Rules, 2014. In furtherance to it, Sec. 192 of the 2013 Act places an explicit prohibition on accepting non-cash assets by the director or by the company from the director or someone related to the director, unless it has acquired specific approval in a general meeting.

What is a consideration?

Section 2(d) of the Indian Contracts Act, 1872 defines consideration as "when, at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstain from doing, or promises to do or to abstain from doing, something, such act or abstinence or promise is called a consideration for the promise." The word ‘consideration’ in reference to the transfer of properties for consideration, therefore, has to be read in light of its definition given in the Contract Act. It was settled in Debi Saran Koiri v. Nandalal Chaubey that a transfer in consideration of natural love and affection is not a transfer for consideration within the meaning of Section 2 of the Contract Act. So also is a transfer in consideration of an expectation of a spiritual and moral benefit. It is a well-settled principle from Patridge v. Gopp that a consideration in a contract for sale, as in all other contracts under the Contract Act, must be a good and valuable consideration. Therefore, a meritorious or gratuitous consideration such as natural love and affection or obedience and submission by way of respect or love may at best be a meritorious or gratuitous consideration, and in no case can it be a good or valuable consideration. Therefore, it is clear from both the legal provisions governing the allotment of shares for consideration other than cash and the judicial interpretation of consideration that a non-cash consideration must have a significant and measurable value in order to be valid for the allotment of shares.

Valuation of Non-Cash Consideration

With regard to this paper, our main concern would be with respect to the evaluation of intangible assets;

therefore, we will only be looking at methods concerning them.

Market Value Method

You can evaluate your intangible assets using the market technique by looking at what other companies have paid for a similar item. For example, if a corporation is unsure how to value their client lists but knows another company just purchased a similar size list for a given amount of money, they might use that figure as evidence of its market value.

The Income Method

The income approach values an asset based on the expected cash flow to the firm over time. Essentially, this strategy presupposes that the asset's current value equals its future income.

Cost Method

Finally, the cost method of intangible asset appraisal is used by businesses to determine the cost of rebuilding or replacing the asset under evaluation. For example, if your asset is brand recognition, you must calculate the cost of recreating that degree of recognition in the market, which includes everything from graphic design to ad placements to favourable news hits.

Valuation of Emerging Assets

Crypto Assests

The volatile nature of cryptoassets represents one of the primary challenges associated with their valuation. This characteristic is often linked with frequent and substantial price variations for these assets. Cryptoassets typically undergo significant upward and downward swings within short time frames. For instance, the value of Bitcoin and other cryptocurrencies can fluctuate intensely, even within a span of a day. This volatility often outpaces that of traditional assets such as stocks or gold, which have a generally steadier depreciation rate. The rapid fluctuation in the value of cryptoassets makes it challenging to pinpoint a single value at any one moment. Additionally, prices for the same cryptoasset often differ between different exchange platforms, which operate distinctly to accommodate the diverse needs of different parties. Thus, there might not be a 'correct' answer to the worth of a cryptoasset at any particular moment. This volatility inherently poses significant challenges in planning and prediction in insolvency scenarios, particularly when the asset must be translated into a set fiat currency amount. It's also worth noting that even stablecoins, which were created to overcome the price volatility issue by anchoring themselves to stable resources, can face sharp price variations depending on their design and the nature of their reserve assets. The price of all these cryptoassets generally depends on public trust and perception and derives almost entirely from demand and supply; hence, it can change following regulatory actions or bans. This makes the valuation of cryptoassets even more complex. Given the volatility and unique characteristics of cryptoassets, their valuation for allotting shares for non-cash consideration can be challenging. In the context of insolvency proceedings, the valuation of cryptoassets becomes a crucial and challenging task. Some of the problems are identified below as:

1. Classification of cryptoassets: The legal definition and classification of cryptoassets like cryptocurrencies, stablecoins, security tokens, utility tokens, etc. are not clearly defined. This leads to uncertainty regarding their treatment under law, for instance, whether they should be considered commodities or currencies. 2. Valuation in Insolvency: The legal framework regarding the valuation

of cryptoassets in cases of insolvency is not properly defined. Complexities arise in determining their real-time value due to their highly volatile nature and how to classify them for valuation purposes.

2. Fraudulent Transfers and Recovery: In cases where insolvency is triggered due to fraudulent activities, the recovery of cryptoassets can prove challenging due to their pseudonymous nature and the difficulties of tracing transactions.
3. Recognition and Enforcement: Recognition and enforcement of creditor rights, ownership rights, and contractual obligations linked to cryptoassets can be challenging given their novel and evolving nature.

Non-Fungible Tokens

For dependable and transparent management, NFT procedures are often carried out by transmitting transactions via the smart contract. It is one of the most significant issues for NFTs, especially when minting NFTs on a large scale, which necessitates uploading the metadata to the blockchain network. Another issue with NFTs is that data inaccessibility complicates their utilisation and restricts the full potential of data reuse. Furthermore, NFT transactions are said to be based on underlying Ethereum systems that provide anonymity. Most importantly, NFTs are not currently subject to government regulation, which means that those who produce, trade, acquire, or invest in them have little or no legal protection. Under the existing legislative framework, intellectual property-related products are classified as taxable property. Under the existing legislative framework, intellectual property-related products are classified as taxable property. There is also the issue of repudiation, which refers to the ability to mimic another entity (human or computer) in the system in order to appear authentic. Furthermore, malicious manipulation of NFT data compromises its integrity. The scenario in which the originator of a statement is unable to decline relates to the security property of no reputability. There is a possibility that information will be discovered by unauthorised users, which would be a violation of privacy. Adding to the list of issues is the fact that NFT systems are separated from one another; as a result, once users choose a product, they can only sell, buy, or trade it within the same ecosystem or network. There is also uncertainty looming around whether trading NFTs is prohibited or not under the Securities Contract Regulations Act, 1956. Trading in NFTs would be considered illegal if it were to be considered a derivative. A derivative, according to Section 2(ac) of the SCRA, is "a contract whose value is derived from the prices of the underlying securities." However, there is a lack of clarity on whether NFTs fall under the definition of derivatives or if they should be regulated differently. To address the issues surrounding NFTs, regulatory interventions are crucial in ensuring the protection of intellectual property rights and creating confidence among users (Ali et al., 2023). If NFTs are considered derivatives, they cannot be traded on virtual platforms as per Section 18a of the SCRA; however, if an NFT is simply a reference to an existing asset and used as proof of its authenticity,

Comparative Analysis of the Legal Position with the United Kingdom

According to Section 593 of the Companies Act, 2006, a company cannot allot shares for consideration other than in cash unless it has been valued by an independent valuer and the same has been furnished within 6 months immediately preceding the allotment of shares. In Zavarco UK Plc v. Sidhu [2021] EWHC 1526 (Ch), the company claimed there was a breach of Section 593 as there was no valuation report provided in the merger deal. In this case, the court reemphasized compiling with the statutory needs of conducting valuation reports independently and how the failure of the same can lead to penalties and criminal consequences.

Conclusion

With regard to emerging assets like cryptocurrency assets, or NFTs, the stance of the Government of India has been consistent, which has been reiterated again by Shaktikantha Das, the Governor of the Reserve Bank of India. He stated that the central bank has major concerns regarding cryptocurrencies and other virtual currencies, citing issues such as money laundering, consumer protection, and the potential for financial instability. Considering the position of the government going for the ban and not regulation, it is highly unlikely that assets like crypto currencies or NFTs will be accepted as considerations for the allotment of shares. Nevertheless, it would be clear from the above arguments, while taking into account the situation of a nation from which the Indian Companies Act has its genesis, that there is no looming hole over the regulation of considerations other than cash in the current 2013 Act. There is hesitancy or stringent provisions in place that regulate their usage in other countries when it comes to non-cash considerations, owing to their volatile nature. However, it is a fact that they are in wide use in the present scenario, and taking into account the expanding nature of assets that could join the line, elaborating on the class or explicitly describing the nature of considerations for allotment of shares in the Companies Act, 2013 would help provide clarity in addressing issues surrounding NFTs and other noncash assets that may merge in the future.

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