

A.C. BHUTERIA & CO.  
CHARTERED ACCOUNTANTS

# Can Bonus Shares Be Issued Instead of Dividend?

| Section 63 Explained

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AN ANALYSIS OF SECTION 63 OF  
THE COMPANIES ACT, 2013



DIAMOND HERITAGE.  
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Kolkata, West Bengal, India

## **I. BACKGROUND : WHAT ARE BONUS SHARES?**

*The issue of bonus shares by a company is a common feature. When a company is prosperous and accumulates a large surplus, it converts this surplus into capital and divides the capital among the members in proportion to their rights. This is done by issuing fully paid shares representing the increased capital. The shareholders to whom the shares are allotted have to pay nothing. The purpose is to capitalize profits which may be available for division or to utilize quasi-capital gains. Bonus shares go by the modern name of “capitalization shares.”*

## **II. LEGAL FRAMEWORK GOVERNING BONUS ISSUE : WHICH SECTION OF THE COMPANIES ACT GOVERNS BONUS SHARES?**

Section 63 of the Companies Act, 2013 (“the Act”), deals with issuance of bonus shares by a company. It states as under:

- (1) A company may issue fully paid-up bonus shares to its members, in any manner whatsoever, out of -
- (i) its free reserves;
  - (ii) the securities premium account; or
  - (iii) 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 -
- (a) it is authorised by its articles;
  - (b) it has, on the recommendation of the Board, been authorised in the general meeting of the company;
  - (c) it has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it;
  - (d) it has not defaulted in respect of the payment of statutory dues of the employees, such as, contribution to provident fund, gratuity and bonus;

- (e) the partly paid-up shares, if any outstanding on the date of allotment, are made fully paid-up;
- (f) it complies with such conditions as may be prescribed.

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

### **III. ANALYSIS AS PER THE ACT : CAN BONUS SHARES BE ISSUED INSTEAD OF DIVIDEND?**

The Act recognizes a clear distinction between the declaration of dividend and the issue of bonus shares. While both mechanisms provide a benefit to shareholders, they differ fundamentally in their legal character, accounting treatment, and commercial consequences. Dividend constitutes a distribution of the profits of the company to its shareholders, resulting in an actual outflow of funds from the company. A bonus issue, on the other hand, involves no distribution of profits. It merely represents the capitalization of the company's accumulated free reserves or securities premium by converting them into paid-up share capital and allotting additional shares to the existing shareholders in proportion to their existing shareholding. Consequently, although the number of shares held by a shareholder increases, the shareholder's proportionate ownership in the company remains unchanged and no immediate monetary benefit is received.

Recognizing this distinction, Section 63(1) of the Act expressly permits companies to issue fully paid bonus shares to existing shareholders from free reserves, securities premium account, or capital redemption reserve. Section 63(2) of the Act further prescribes pre-conditions, including that the company must not have defaulted in payment of interest or principal on fixed deposits, debt securities, statutory dues, or employee-related payments.

Most critically, Section 63(3) of the Act provides that bonus shares shall not be issued in lieu of dividend. The expression "in lieu of" ordinarily means "instead of" or "as a substitute for". Accordingly, the provision prohibits a company from issuing bonus shares as a replacement for dividend that would otherwise be distributable to shareholders. The object of the provision is to ensure that shareholders are not deprived of an actual return on their investment through compulsory capitalization of profits. While dividend

provides shareholders with an immediate economic benefit by way of cash or other distributable assets, a bonus issue merely converts one component of shareholders' funds into another. Although the company's reserves stand reduced, there is a corresponding increase in its paid-up share capital and no reduction in the company's overall net worth. Likewise, the shareholder does not receive any immediate accretion in wealth since the market price of the shares ordinarily adjusts after the bonus issue so that the aggregate value of the shareholder's investment broadly remains unchanged.

The question that arises for consideration is what constitutes "bonus shares issued in lieu of dividend" within the meaning of Section 63(3) of the Act, and whether a company is mandatorily required to declare a dividend before undertaking a bonus issue. Neither Section 63 nor any other provision of the Act mandates that dividend must precede or accompany a bonus issue. A company may, based on sound commercial considerations, decide to retain its profits, strengthen its capital base and capitalize its accumulated reserves by issuing bonus shares without declaring any dividend. Such a course of action would not violate Section 63(3) of the Act, provided that the bonus issue is undertaken for genuine purposes of capitalization and not as a substitute for the payment of dividend. Any resolution, whether at the Board level or at a general meeting, that purports to issue bonus shares as a substitute for a cash dividend would be ultra vires this provision and liable to be set aside.

The prohibition reflects a sound principle of corporate law. Dividend and bonus shares serve distinct purposes and produce different legal consequences. Dividend constitutes an appropriation and distribution of profits, whereas a bonus issue merely restructures the company's capital by converting accumulated reserves into share capital. The statutory embargo under Section 63(3) of the Act therefore preserves this distinction and ensures that capitalization of reserves is not employed as a device to avoid the distribution of profits to shareholders where the company intends to reward them for its earnings.

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