

If 100 Shares Of \$50 Par Value Stock Were Issued At \$75 Per Share, How Much Would Constitute Capital

Introduction

If 100 Shares Of \$50 Par Value Stock Were Issued At \$75 Per Share, How Much Would Constitute Capital is a fundamental question in understanding corporate accounting and the mechanics of share issuance. When a company issues shares, it often does so at a price different from the par value, leading to different components of capital being affected. This article explores the concepts of authorized capital, issued capital, paid-up capital, and additional paid-in capital, all in the context of issuing 100 shares at a premium. We will analyze how the total capital is calculated, the implications for shareholders and the company, and the accounting entries involved in such a transaction.

Understanding Key Terms

Par Value of Shares

The par value, also known as face value, is the nominal or stated value of a share as specified in the company's articles of incorporation. In our scenario, each share has a par value of \$50. It is a legal concept that often has minimal practical significance but serves as a baseline for accounting purposes.

Issued Shares

Issued shares refer to the total number of shares that a company has actually distributed to shareholders. In this case, the company issues 100 shares.

Paid-up Capital

This is the amount of capital that shareholders have actually paid to the company in exchange for shares. It includes the par value and any amount paid over and above the par value (premium). The total paid-up capital is essential for assessing the company's equity base.

Share Premium or Additional Paid-in Capital

The excess amount received over the par value of shares is termed as share premium or additional paid-in capital. It reflects the extra amount investors are willing to pay above the nominal value, often due to the company's reputation, future prospects, or market conditions.

Calculating the Capital Components of the Issue

Step 1: Determine the total proceeds from the issuance

- Number of shares issued = 100
- Issue price per share = \$75
- Total proceeds = 100 shares × \$75 = \$7,500

Step 2: Calculate the total par value of issued shares

- Par value per share = \$50

- Total par value = 100 shares × \$50 = \$5,000

Step 3: Determine the share premium or additional paid-in capital

- Amount received over par per share = \$75 - \$50 = \$25
- Total share premium = 100 shares × \$25 = \$2,500

Components of Capital from the Issue

1. Share Capital (or Authorized Capital)

The share capital reflects the total value of shares issued at their par value. In our scenario, this is \$5,000.

2. Share Premium (or Additional Paid-in Capital)

The amount received over the par value, which is \$2,500, is recorded separately in the share premium account. This does not form part of the statutory capital but is considered part of the company's shareholders' equity.

3. Total Capital Recognized

In accounting terms, the total capital contributed by shareholders is the sum of the share capital and the share premium:

- Share capital: \$5,000
- Share premium: \$2,500
- Total capital contribution: \$7,500

Accounting Treatment of the Share Issue

Journal Entries

To record the issuance of 100 shares at \$75 each with a par value of \$50, the following journal entries are made:

1. When shares are issued:

Dr. Bank/ Cash	\$7,500
Cr. Share Capital (at par)	\$5,000
Cr. Share Premium Account	\$2,500

This entry reflects the receipt of cash, the recognition of the share capital at par value, and the premium received over par.

Implications for the Company and Shareholders

Impact on the Company's Capital Structure

Issuing shares at a premium increases the company's paid-up capital without issuing new shares or

increasing the nominal capital. The additional amount (premium) enhances the company's reserves and can be used for various corporate purposes, such as expansion, debt repayment, or dividends.

Legal and Regulatory Considerations

Many jurisdictions require companies to maintain a minimum share capital based on par value or statutory provisions. The issuance at a premium must comply with securities regulations, including disclosures about the premium and its use.

Shareholder Perspective

Existing shareholders benefit from the increased capital base, which can lead to enhanced corporate stability. New shareholders who purchase at a premium may expect future growth or dividends. The premium also indicates investor confidence in the company's prospects.

Additional Factors to Consider

Authorized Capital

Before issuing shares, the company must have authorized capital sufficient to cover the issuance. If not, the articles of incorporation need to be amended to authorize more shares.

Issue Price vs. Market Price

The issue price (\$75) might be different from the current market price. Issuance above par value often reflects market sentiment, company valuation, or strategic considerations.

Tax and Regulatory Aspects

In some jurisdictions, share premiums are subject to specific regulations, and the company may need to record and report them separately. Additionally, stamp duties or other taxes might apply to the issuance process.

Conclusion

In summary, when 100 shares with a \$50 par value are issued at \$75 per share, the company's capital comprises the par value of the shares issued (totaling \$5,000) and the share premium (totaling \$2,500). The total amount received from the issuance is \$7,500, reflecting both the nominal capital and the premium paid by investors. Understanding these components is crucial for accurate financial reporting, regulatory compliance, and strategic decision-making. Proper accounting treatment ensures transparency and reflects the true financial position of the company, benefitting shareholders, creditors, and other stakeholders alike.

Frequently Asked Questions

What is the total amount received from issuing 100 shares at \$75 per share?

The total amount received is $100 \text{ shares} \times \$75 = \$7,500$.

What is the par value of each share in this issuance?

The par value of each share is \$50.

How much of the total amount received constitutes the share capital

(or common stock) account?

The share capital constitutes $100 \text{ shares} \times \$50 = \$5,000$.

What is the amount considered as additional paid-in capital in this issuance?

The additional paid-in capital is the excess over par: $\$7,500 - \$5,000 = \$2,500$.

Why is only the par value used to determine the share capital amount?

Because the share capital represents the nominal value assigned to the stock, which is recorded in the share capital account, while the excess is recorded as additional paid-in capital.

If the stock was issued at a premium, how is the capital amount recorded in the books?

The share capital account is credited with the total par value (\$5,000), and the remaining amount (\$2,500) is credited to additional paid-in capital.

Would the total capital contributed be different if the shares were issued at a different price?

Yes, the total capital contributed depends on the issue price; issuing at a higher price increases total capital, while issuing at a lower price decreases it.

How does issuing shares above par value impact the company's financial statements?

It increases both the share capital (by par value) and additional paid-in capital, strengthening the company's equity position.

Is the entire amount received from issuing stock considered part of the company's capital?

No, only the par value portion is part of the share capital; the excess over par is recorded as additional paid-in capital, both contributing to total shareholders' equity.

Additional Resources

Understanding Capital Formation in Stock Issuance: A Deep Dive into Par Value and Issue Price

When a company issues shares to raise capital, the transaction involves several important concepts—most notably the par value of the stock, the issue or selling price, and the total capital generated from the offering. A common point of confusion for investors and students of finance is how these values interplay to determine the actual capital that a company records on its balance sheet. For example, if a company issues 100 shares of stock with a par value of \$50 at an issue price of \$75 per share, how much constitutes the company's capital? This question encapsulates fundamental accounting principles and provides insight into how companies structure their equity and capital reserves.

This article explores this scenario comprehensively, dissecting the components involved in stock issuance, the accounting treatment of par value and premium, and the implications for a company's financial statements. Through detailed analysis, readers will gain a clearer understanding of how companies record capital and the significance of these figures in financial reporting and corporate finance.

What Is Par Value and Why Does It Matter?

Definition of Par Value

Par value, also known as face value or nominal value, is the stated value assigned to a share of stock by the issuing company at the time of incorporation or issuance. It often appears on the stock certificate and is a legal concept that historically served as a minimum price at which shares could be issued. In modern corporate finance, par value is largely symbolic and has little relation to the market value or the actual price at which shares are bought and sold.

Historical Context and Legal Significance

Historically, par value was introduced to protect creditors by establishing the minimum amount of capital that shareholders had committed to the company. It also limited the liability of shareholders to the amount paid for the stock. Although many jurisdictions have abolished or reduced the importance of par value, it still exists in many legal systems and remains a crucial element in the accounting record of stock issuance.

Par Value Versus Market Price

It's essential to distinguish between par value and the market (or issue) price:

- Par Value (\$50 in our scenario): The nominal, fixed value assigned per share.
- Issue Price (\$75 in our scenario): The actual price paid by investors when purchasing the shares.

In our example, the shares are issued at a premium because the issue price exceeds the par value.

Dissecting the Scenario: 100 Shares at \$75 per Share with a Par Value of \$50

Basic Data Summary

- Number of Shares Issued: 100
- Par Value per Share: \$50
- Issue Price per Share: \$75

This information provides the foundation for calculating the total capital raised and the components of the company's equity.

Calculating the Total Amount Received from Shareholders

The total proceeds from issuing 100 shares at \$75 each are straightforward:

- Total Issue Price Revenue: $100 \text{ shares} \times \$75 = \$7,500$

This total includes both the amount that corresponds to the par value and any premium paid over the par value.

Breaking Down the Capital Components

The total capital raised from this issuance can be divided into:

1. Legal Capital (or Share Capital): The amount attributable to the par value.
2. Share Premium (or Additional Paid-in Capital): The excess amount paid over the par value.

Accounting Treatment of Par Value and Premium

Recording Share Capital

The company's share capital (or common stock account) is credited with the aggregate par value of the issued shares:

- Share Capital = Number of Shares × Par Value

- Share Capital = $100 \times \$50 = \$5,000$

This amount reflects the nominal value of the issued shares and is recorded on the company's balance sheet under shareholders' equity.

Recording Share Premium

The excess over the par value, known as the share premium or additional paid-in capital, is recorded separately:

- Share Premium = Total Proceeds - Par Value of Shares Issued

- Share Premium = $\$7,500 - \$5,000 = \$2,500$

This amount represents additional capital contributed by shareholders beyond the legally required minimum and is also shown under shareholders' equity, often as a distinct account.

Journal Entry Illustration

The issuance journal entry would typically be:

Account	Debit	Credit
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Bank (or Cash)	\$7,500	
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To Share Capital (Par Value)		\$5,000
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To Share Premium (Additional Paid-in Capital)		\$2,500
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This entry reflects the receipt of cash and the corresponding increase in equity accounts.

How Much Constitutes Capital? Analyzing the Figures

Understanding 'Capital' in This Context

In accounting, "capital" generally refers to the total amount of funds invested in the company by shareholders, which is reflected on the balance sheet as shareholders' equity. When considering the specific question—"How much would constitute capital?"—it's crucial to clarify whether the focus is on:

- The par value (minimum legal capital),
- The total amount of cash received,
- Or the total recorded equity including premium.

Answering the Core Question

Based on standard accounting principles:

- The nominal or legal capital (or share capital) that "constitutes" the core capital is \$5,000, representing the par value of the issued shares.
- The total amount of capital raised, including the share premium, is \$7,500.

Therefore, if the question is about the amount that is officially recorded as share capital, the answer is \$5,000. If it concerns total cash inflow or total equity attributable to shareholders, it is \$7,500.

Implications for the Company's Financial Statements

Balance Sheet Presentation

The company's balance sheet would reflect:

- Share Capital (or Common Stock): \$5,000
- Share Premium (or Additional Paid-in Capital): \$2,500
- Total Shareholders' Equity: \$7,500

These figures show the legal structure of the company's equity base and the premium paid by investors.

Impact on Financial Ratios and Investor Perception

- Debt-Equity Ratio: Higher equity can improve leverage ratios.
- Market Perception: The premium indicates investor confidence and willingness to pay above par value.
- Future Flexibility: The company may issue additional shares at similar or different premiums, affecting future capital structure.

Legal and Practical Considerations

Legal Restrictions and Par Value

In many jurisdictions, companies are restricted from issuing shares below par value, ensuring a minimum level of capital is maintained. This protects creditors and maintains the company's financial

integrity.

Use of Share Premium

The share premium can often be used for specific purposes such as issuing bonus shares, writing off expenses related to share issuance, or other corporate activities, depending on jurisdictional laws.

Market Factors and Investor Relations

While par value is mostly symbolic today, the issue price reflects market conditions and investor sentiment. A premium indicates strong demand and perceived value, which can influence future fundraising and valuation.

Conclusion

The issuance of 100 shares at a \$75 per share price, with a par value of \$50, exemplifies key principles of equity financing. The total proceeds amount to \$7,500, comprising \$5,000 recorded as share capital and \$2,500 as share premium.

In terms of what constitutes 'capital':

- The legal or nominal capital is \$5,000, representing the par value of the issued shares.
- The total capital raised from shareholders, including the premium, is \$7,500.

This distinction is vital for understanding a company's financial structure, legal standing, and the accounting treatment of share issuance. It highlights how companies leverage both nominal values and market-driven premiums to build their equity base, shaping their financial health and investor perception.

In summary, while the par value forms the core legal capital, the premium reflects investor confidence and additional contributions, both of which are integral to the company's financial identity.

Understanding these nuances offers investors, accountants, and students a clearer perspective on corporate finance fundamentals and the intricacies of share issuance.

End of Article

If 100 Shares Of 50 Par Value Stock Were Issued At 75 Per Share How Much Would Constitute Capital

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