Dividend Provisions

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Topics

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Meaning of Dividend

The term 'dividend' is derived from the Latin word '*dividendum*' which means 'that which is to be divided'. Dividend is that part of the profits of the company which is distributed amongst its shareholders. It differs from interest in the sense that it does not arise out of contractual obligations. Dividend implies two things—(*i*) payment out of profits, and (*ii*) actual release of some assets. Issue of bonus shares or right shares to the existing members is not considered as dividend because the former does not involve release of any assets and the latter has no relation with the profits of the company. Every trading company has an implied inherent power to distribute its net earnings or profits to the shareholders in the shape of dividends. Power to declare dividends, therefore, need not expressly be given by the Memorandum or Articles of Association. Articles may, however, regulate the manner in which the dividends are to be paid.

As per Section 2(35) of the Companies Act, dividend includes 'interim dividend'.

Legal Provisions regarding Dividend

1. Declaration of dividend to be out of the Profits

As per Section 123, dividend by a company for any financial year can be paid or declared only out of:

(*a*) Profits of the company of that year arrived at after providing for depreciation in accordance with the provisions of the Act, or

(*b*) Profits of the company for any previous financial year or years after providing for depreciation as per the provisions of the Act, or

(*c*) Out of both, or

(*d*) Money provided by the Central or State Governments for the payment of dividends in pursuance of the guarantee given by that Government.

2. Provision for Depreciation

Before any dividend can be paid out of profits of any financial year, a company is required to provide depreciation as per the provisions of the Schedule II of the Companies Act 2013.

3. Transfer of Profits to Reserves

A company may, before the declaration of any dividend in any financial year, transfer such percentage of its profits for that financial year as it may consider appropriate to the reserves of the company.

4. Declaration of Dividend out of Reserves

A company can pay dividend out of its 'reserve funds' created out of the undistributed profits of the company for any previous financial year or years (arrived at after providing for depreciation as required).

As per the Companies (Payment and Declaration of Dividend) Rules 2014, in the event of inadequacy or absence of profits in any year, a company may declare dividend out of free reserves subject to the fulfillment of the following conditions, namely:—

(1) The rate of dividend declared shall not exceed the average of the rates at which dividend was declared by it in the three years immediately preceding that year:

Provided that this rule shall not apply to a company, which has not declared any dividend in each of the three preceding financial year.

(2) The total amount to be drawn from such accumulated profits shall not exceed one-tenth of the sum of its paid-up share capital and free reserves as appearing in the latest audited financial statement.

(3) The amount so drawn shall first be utilised to set off the losses incurred in the financial year in which dividend is declared before any dividend in respect of equity shares is declared.

(4) The balance of reserves after such withdrawal shall not fall below fifteen per cent of its paid up share capital as appearing in the latest audited financial statement.

(5) *No company shall declare dividend unless carried over previous losses and depreciation not provided in previous year or years are set off against profit of the company of the current year*.

5. Payment of Dividend out of Capital Profits

Profit arising out of the sale or revaluation of capital assets is termed as capital profit. Capital profits may be utilised for the purposes of declaration of dividend provided:

(*a*) these have been realised in cash,

(*b*) these remain as profits after revaluation of all the assets and liabilities, and

(*c*) there is nothing in the Articles of Association of the company prohibiting their distribution amongst the shareholders in the shape of cash dividends.[2]

Revocation of Declared Dividend

Dividend declared with the approval of the shareholders creates a debt due to the shareholders. Generally, dividend declared cannot be revoked except with the approval of the shareholders in the event:

- of the intervening circumstances after the declaration, such as the outbreak of a war, massive fire destroying the properties of the company, imposition of hard taxes, or other causes diminishing the assets of the company.
- where a dividend has been declared illegally or violating the requirements of the law, the board of directors would be justified in revoking the dividend.

2.Foster *v*. The New Trinidad Lake Ashphalt Co. Ltd. (1901)

Entitlement of Dividend

Equity Shareholders

A company can pay dividend only to the shareholders of that company

(*i*) In respect of shares held in **electronic form**, to those persons whose names appear as beneficial owners in the statement(s) furnished by the Depository(ies) as on the close of the market day prior to book closure or, in the case of Interim Dividend, on the record date; or

(*ii*) In respect of shares held in **physical form**, to those shareholders whose names appear on the company's Register of Members after giving effect to all valid share transfers in physical form lodged with the company before the date of book closure or, in the case of Interim Dividend, on the record date; and

Preference shareholders

(*a*) Preference shares carry a preferential right as to dividend in accordance with the terms of the issue and the Articles, and hence preference shareholders are paid dividend before the dividend is paid to the equity shareholders of the company.

(*b*) Preference shares may be cumulative or non-cumulative. Dividend in arrears on cumulative preference shares can be paid in a later year where there are profits to justify such payment. In the case of non-cumulative preference shares, if no dividend can be paid in a year, there is no right to receive it in future years. After paying the preference dividend and any arrears of dividend on cumulative preference shares, residual profit may be utilized for payment of dividend to equity shareholders. However, where participating preference shares have been issued, the holders thereof also have the right to participate in such residual profit.

Equity Shares with Differential Rights

Where a company issues equity shares with differential rights as to dividend, the terms of issue of such shares will govern the rights of each such class of holders as to receipt of dividend.

Payment of Dividend in proportion to amount paid up on Shares

A company may, if so authorised by its articles, pay dividends in proportion to the amount paid up on each share where a larger amount is paid up on some shares than on others. (*Section 51*)

Adjustment of Calls in arrears against Dividend Payable

Secretarial Standard-3 (SS-3), issued by the Council of the Institute of Company Secretaries of India provides:

(*a*) In the case of listed companies, calls in arrears or any other sum due from a member in the capacity of a member may be adjusted against the dividend payable to him after giving such notice, as may be required.

(*b*) In the case of other companies, unless the Articles provide otherwise, any other sums due from a member, in a capacity other than as a member, may also be adjusted against the dividend payable to him.

Prohibition on Payment of Dividend

A company which has failed to repay the deposit or part thereof or any interest thereon within the stipulated time (under sections 73 and 74) shall not, so long as such failure continues, declare any dividend on its equity shares. [Section 123(6)]

Dividend in Abeyance

If a member authorises the company in writing to pay the dividend to the transferee specified in the instrument of transfer lodged with the company, the company should act upon such authorisation. However, in the case of shares which have not been transferred because the ownership thereof is in dispute, or where attachment/prohibitory orders have been passed by a court or statutory authority, dividend should be held in abeyance by transferring to the Unpaid Dividend Account.

Procedure for Declaration of Dividend

A company which intends to declare and pay dividend should adopt the following procedures. Further, in case the company's shares are listed on the Stock Exchanges, additional requirements relating to Listing Agreements are to be followed.

1. Recommendation by Board of Directors

Dividend can be declared only on the recommendation of the Board of Directors of the Company. The shareholders do not have any power to declare any dividend. The Board of Directors after considering and approving the financial statements of the company, determines the rate of dividend to be declared and then recommends the same to the shareholders. For this purpose, a Board Meeting shall be convened to pass the resolution for purposes of

- rate of dividend and the amount of dividend to be paid
- book closure date for dividend
- date of annual general meeting
- Bank with which the account shall be opened for the remittance of dividend.

2. Approval by the Shareholders

The dividend recommended by the Board of Directors is declared by a resolution passed at the Annual General Meeting by the shareholders. The declaration of dividend should form part of an ordinary business item to be transacted in the notice of the Annual General Meeting. While approving the rate of dividend at the Annual General Meeting, the shareholders have power to declare a lower rate of dividend than what is recommended by the Board but they have no power to increase the amount or the rate of dividend so recommended. Dividend when declared becomes debt against the company.

Usually, dividend is declared at the annual general meeting. But a company which has not declared dividend at an annual general meeting may do so at a subsequent general meeting.

A company which has declared dividend at a general meeting is not permitted to declare dividend for the second time in that year.

3. Dividend includes Interim Dividend

As per the Companies Act, 2013, dividend includes interim dividend [*Section 2(35*)]. Interim dividend can be declared by the Board of Directors if they have authority to do so. Further, the provisions on payment of dividend contained in Section 123, 124 and 127 shall apply to interim dividend also.

4. Dividend to be deposited in a Separate Bank Account

The company must deposit the dividend amount (including interim dividend) within 5 days of its declaration in the separate bank account opened for this purpose. The interim dividend will have to be deposited in a bank account within 5 days of the Board Meeting whereas final dividend will have to be deposited within 5 days from the date of Annual General Meeting in which it was approved by the shareholders.

5. Dividend to be paid by cheque or warrant

Section 123(5) of the Companies Act, 2013 provides that the dividend payable in cash may be paid either by cheque or warrant or in any electronic mode to the shareholder entitled to the payment of dividend.

6. Time frame for payment of Dividend

As per Section 127 of the Companies Act, 2013, the dividend is to be paid or the warrants in respect thereof shall be posted within 30 days from the date of declaration of dividend.

7. Transfer of Unpaid Dividend

As per Section 124 of the Act, where a dividend has been declared by a company but has not been paid (or claimed) within 30 days from the date of declaration, the company shall within 7 days from the expiry of the period of 30 days transfer the total amount of dividend which remains unpaid or unclaimed to a special account to be opened by the company in that behalf with any Scheduled Bank which is called "Unpaid Dividend Account. Interest at the rate of 12% p.a. is payable by the company for delay in making the above transfer.

8. Transfer of unpaid or unclaimed dividend to the Investor Education and Protection Fund

Any amount of dividend which remains unpaid or unclaimed for a period of 7 years from the date it became due for payment shall be transferred by the company to the Investor Education and Protection Fund [*Section 124(5)*]. When making a transfer to the Fund, the company shall furnish to the authority appointed by the Central Government, the details as prescribed in this respect. The said fund shall be utilised for promotion of investor awareness and protection of the interests of investors.

In case of any *default* in complying with these provisions, the company and every officer of the company who is in default shall be punishable with the fine as prescribed.

Penalty for Failure to Pay Dividends within 30 Days

Where a dividend has been declared by a company but has not been paid, or the warrant in respect thereof has not been posted, within 30 days from the date of the declaration, to any shareholder entitled to the payment of the dividend, every director of the company knowingly a party to the default, shall be punishable with simple imprisonment for a term which may extend to 2 years and shall also be liable to a fine of ₹ 1000 for every day during which such default continues. The company shall also be liable to pay simple interest at the rate of 18% per annum during the period for which such default continues (*Sec. 127*).

However, no offence shall be deemed to have been committed in the following cases:

(1) where a dividend is not legally declared or a declaration of dividend is legally untenable (Reference Case: *Amalgamated Commercial Traders Pvt. Ltd. v. ACK Krishnaswami);*

(2) where the dividend could not be paid by reason of the operation of any law;

(3) where a shareholder has given directions to the company regarding the payment of the dividend and those directions cannot be complied with;

(4) where there is a dispute regarding the right to receive the dividend;

(5) where the dividend has been lawfully adjusted by the company against any sum due to it from the shareholder; or

(6) where, for any other reason, the failure to pay the dividend or post the warrant within the period aforesaid was not due to any default on the part of the company.

Investor Education and Protection Fund

The Central Government has established a fund called the Investor Education and Protection Fund under Section 125. The following amounts are credited to the fund:

(*a*) the amount given by the Central Government by way of grants after due appropriation made by Parliament by law in this behalf for being utilised for the purposes of the Fund;

(*b*) donations given to the Fund by the Central Government, State Governments, companies or any other institution for the purposes of the Fund;

(*c*) the amount in the Unpaid Dividend Account of companies transferred to the Fund under section 124 (5);

(*d*) the amount in the general revenue account of the Central Government which had been transferred to that account immediately before the commencement of the Companies (Amendment) Act, 1999, and remaining unpaid or unclaimed on the commencement of this Act;

(*e*) the amount lying in the Investor Education and Protection Fund under section 205C of the Companies Act, 1956;

(*f*) the interest or other income received out of investments made from the Fund;

(*g*) the amount received through disposal of securities allotted in the fictitious names under section 38;

(*h*) the application money received by companies for allotment of any securities and due for refund which has remained unclaimed for a period of seven years from the date it became due for payment;

(i) the amount remaining unpaid on account of matured deposits or debentures with companies and interest accrued on that;

(j) redemption amount of preference shares remaining unpaid or unclaimed for 7 or more years;

(k) any other amount as be prescribed.

Utilisation of Fund

The Fund can be utilised for promotion of investors, awareness and protection of the interests of investors in accordance with the prescribed rules. As per Section 125(3)of the Companies Act, the Fund shall be utilized for:

(*a*) the refund in respect of unclaimed dividends, matured deposits, matured debentures, the application money due for refund and interest thereon;

(*b*) promotion of investors' education, awareness and protection;

(*c*) distribution of any disgorged amount among eligible and identifiable applicants for shares or debentures, shareholders, debenture-holders or depositors who have suffered losses due to wrong actions by any person, in accordance with the orders made by the Court which had ordered disgorgement;

(*d*) reimbursement of legal expenses incurred in pursuing class action suits under sections 37 and 245 by members, debenture-holders or depositors as may be sanctioned by the Tribunal; and

(*e*) any other purpose incidental thereto.

Interim Dividend

Dividend declared by the board of directors of a company between two annual general meetings is called interim dividend. As per Section 2(35) of the Companies Act dividend includes interim dividend also. The Board of directors has the power to declare interim dividend.

The board may from time to time pay to the members such interim dividends as appear to it to be justified by the profits of the company. An interim dividend is only a payment on account of the whole dividend for the year. If the working of the whole year results in loss, payment of interim dividend will amount to the payment of dividend out of capital and the directors will be personally liable to make good to the company the amount of interim dividend improperly disbursed.

It is prudent to prepare interim financial statements to ascertain the amount of profits earned and to see whether the profits for the accounting period up-to-date sufficiently justify the payment of an interim dividend. It is essential for a company to provide depreciation for the whole of the year and not proportionately for any fraction of the year before declaring interim dividend. This is because provision for depreciation is a condition precedent for declaration or payment of any dividend. While final dividend may be paid out of free reserves, no interim dividend should be paid by transfers out of any reserves. The Board should take into account the specified percentage required to be transferred to reserves before declaration of interim dividend.

As per Section 123(3) of the Companies Act 2013, the Board of Directors of a company may declare interim dividend during any financial year out of the surplus in the profit and loss account and out of profits of the financial year in which such interim dividend is sought to be declared:

Provided that in case the company has incurred loss during the current financial year up to the end of the quarter immediately preceding the date of declaration of interim dividend, such interim dividend shall not be declared at a rate higher than the average dividends declared by the company during the immediately preceding three financial years.

The amount of interim dividend is required to be deposited in a separate bank account within five days from the date of declaration of such dividend [section 123(4)]. The amount of interim dividend so deposited) shall be used for payment of interim dividend. The provisions of the act applicable to dividend are also applicable to interim dividend.

Procedure to declare Interim Dividend

(*i*) Articles of Association must authorise the directors to declare interim dividend.

(*ii*) Meeting of Board of Directors is to be called to declare interim dividend and decide the record date.

(*iii*) Board of Director in their meeting has to pass a resolution declaring the interim dividend.

(*iv*) Open a separate bank account and credit the amount of dividend within 5 days from the date of declaration of dividend.

(*v*) Make the payment or issue dividend warrant within 30 days from the date of declaration.

(*vi*) Transfer the unpaid or unclaimed dividend to the 'Unpaid Dividend Account' within 7 days of the expiry of period of 30 days from the declaration.

Revocation of Interim dividend. Interim dividend is to be paid within 30 days of declaration. Since the provisions applicable to dividend apply to interim dividend also, the interim dividend becomes debt due once it is declared. Thus, interim dividend can be revoked under the same circumstances where dividend can be revoked.