

Declaration of Dividend

DIVIDEND

Meaning: Dividend means the portion of the profit received by the shareholders from the company's net profit, which is legally available for distribution among the members. Therefore, dividend is a return on the share capital subscribed for and paid to its shareholders by a company.

Dividend defined under section 2(14A) of the Companies Act, 1956, includes any interim dividend.

Types of dividend

There may be two types of dividend:—

- (a) Interim dividend, and
- (b) Final dividend.

Meaning of Interim dividend

Dividend is said to be an interim dividend, if it is declared by the Board of directors between two annual general meetings of the company. However, all the provisions relating to the payment of dividend shall be applicable on interim dividend also.

Meaning of Final dividend

Dividend is said to be a final dividend if it is declared at the annual general meeting of the company. Final dividend once declared becomes a debt enforceable against the company.

Compulsory requirement for making provisions for depreciation before payment of dividend

As desired by section 205 of the Act, no company can pay dividend in any year without charging depreciation in the profit and loss account for the current year and that there is no balance of un provided depreciation of any earlier year or years.

However, the Central Government has power to allow any company in the public interest to pay dividend for any financial year out of the profits for that year or any previous financial year without providing for depreciation. [Section 205(1)(c)] The application is required to be filed to the Central Government electronically in E-form-23AAC.

Guidelines for providing depreciation before payment of dividend

1. Provision for depreciation as per section 205(2), is a condition precedent for declaration or payment of dividend.
2. Depreciation can be provided in any of the following ways:

- (a) To the extent specified in section 350; or
 - (b) In respect of each item of depreciable asset;

$$\text{Depreciation} = 95\% \text{ of original cost of asset} \times \text{Period of life of the asset}$$
 - (c) Any other basis approved by the Central Government which has the effect of writing off by way of depreciation 95% of the original cost to the company of a depreciable asset on the expiry of the specified period; or
 - (d) Any other basis approved by the Central government in case where no rate of depreciation has been prescribed in respect of any asset under Schedule XIV of the Companies Act, 1956 or rules thereunder.
3. The original cost is only for the purpose of determining the quantum of annual installment of depreciation under the straight-line method and determination of the specified period in accordance with section 205(a).
 4. Specified period in respect of any depreciable asset means the number of years at the end of which 95% of the original cost of the asset will have been provided for by way of depreciation, if depreciation were to be provided in accordance with the provision of section 350.
 5. Specified period is determined at the time of purchase of an asset in accordance with the procedures laid down in section 205(5) read with section 350 with reference to the rate of depreciation.
 6. Specified period once determined may not be re-computed.
 7. If a company has provided for depreciation on any asset in the manner mentioned in section 205(2)(b) or (c), and such asset is sold, discarded, demolished or destroyed, then the written value of such asset at the end of the financial year in which it is sold, discarded, demolished or destroyed, shall be written off in accordance with the proviso of section 350.
 8. According to the proviso of section 350, if there is any excess of the written down value of such asset over its sale proceeds or its scrap value, such excess value shall be written-off in the financial year in which the asset is sold, discarded, demolished or destroyed.
 9. The Central Government may, if it thinks necessary to do so in the public interest, allow any company to declare or pay dividend for any financial year out of the profits of the company for that year or any previous financial year(s) without providing for depreciation.
 10. If a company has not provided for depreciation for any previous financial year(s) then the company shall before declaring or paying dividend for any financial year, provide for such depreciation.
 11. Arrears of depreciation, if any, for any previous year(s) must also be provided for, before declaring any dividend.

Compulsory transfer of certain percentage of profit to reserves

Every company shall transfer a portion of its net profit of the year to general reserve before deciding to pay dividend. The amount of net profit transferred to reserve shall vary

with the rate of dividend proposed to be paid and as per the Companies (Transfer of Profits to Reserves) Rules, 1975.

Restriction on payment of dividend on equity shares

A company, which has failed to redeem its preference shares as per section 80A, so long as such failure continues, shall not declare any dividend on its equity shares. [Section 205(2B)]

Final dividend to be declared at an annual general meeting

A final dividend is declared at an annual general meeting where, among other things, the annual accounts are considered and adopted.

Restriction on company's power: It is beyond the powers of the company to declare a further dividend at a general meeting after the declaration of dividend at the annual general meeting.

However, as per Department of Company Affairs clarification vide Circular No. 22 [7/9/74-CL-II], dated 25-9-1975 a company, which could not declare a dividend at an annual general meeting, may declare the dividend at a subsequent general meeting as there is no provision in the Companies Act prohibiting the declaration of dividend at a general meeting other than the annual general meeting of the company (Regulation 85 of Table A of Schedule I) unless otherwise, provided in the Articles of Association

It was decided by the Calcutta High Court in *Biswa Nath Pd. Khaitan v New Central Jute Mills Ltd.* (1961) that a company, which could not declare a dividend at an annual general meeting, may do so at a subsequent general meeting. On the other hand, where a company has declared a dividend at a general meeting neither the company nor its directors can declare a further dividend for the same year.

Declaration of dividend out of previous years profits transferred to the reserves

In case if the current year's net profits are not adequate or not available, a company may draw the required amount from reserves created out of transfer of profit in previous years as per the Companies (Declaration of Dividend out of Reserves) Rules, 1975 subject to the following conditions:—

- (i) The rate of dividend declared shall not exceed the average rate of dividend declared in the five years preceding the current year or 10% of the paid-up capital, whichever is less.
- (ii) The maximum amount to be drawn from the accumulated profits earned in previous years and transferred to the reserves shall not exceed 10% of the paid-up capital and reserves and the amount so drawn shall be first utilised for writing off losses incurred before declaration of any dividend in respect of preference or equity shares.
- (iii) The balance remaining in the reserves after such drawal shall not fall below 15% of the paid-up share capital.

Articles authorization is necessary for payment of dividend

Unless there is a suitable provision in the articles for authorisation for payment of dividend, the Board will not be able to recommend dividend for the approval of members. Similarly, unless there is a provision in the articles authorising the Board to approve for payment of interim dividend, the Board cannot take any action in respect of payment of interim dividend.

If the articles do not contain the provisions for authority to pay dividend, it should be suitably amended before taking any decision by the Board of directors of the company.

Recommendation of dividend by the Board is compulsory

If the Board does not recommend any dividend, the company in general meeting cannot consider and approve any dividend for payment. **The company in general meeting cannot also increase the rate of dividend recommended by the Board.**

Board's recommendation can be withdrawn before communication to others

Since the director's recommendation of dividend is only a proposal, it can be withdrawn by the Board before it is included in the notice for the annual general meeting.

Dividend becomes unsecured debt after approval in the general meeting

Where a dividend is approved by the shareholders at the annual general meeting, it becomes a debt against the company and it is deemed to be receivable by the members only if it is approved by the members in the AGM.

Dividend shall be paid to registered shareholders

Section 206 provides that no dividend shall be paid by a company in respect of any shares therein except:—

- (a) to the registered holders of such shares or to his order to his bankers; or
- (b) in case if the share warrants has been issued in respect of shares u/s 114, to the bearer of such warrants or to his bankers.

In the case of joint holdings, the dividend shall be paid to the person whose name is registered first in the books.

Dividend warrants shall be posted/sent/credited within 30 days from the date of approval

Pursuant to section 207, where a dividend has been declared by a company, it has to be paid or the warrant in respect thereof has to be sent/posted within 30 days from the date of declaration to the shareholders entitled to the same. Dividend warrants in respect of interim dividend shall also be posted within 30 days from the date of approval of the Board of directors of the company.

If the above provision could not be followed for the following reasons, no offence shall be deemed to have been committed by the company:—

- (a) where the dividend could not be paid due to reason of operation of law;

- (b) where a shareholder has given directions to the company regarding the payment of dividend and those directions could not be complied with;
- (c) where there is a dispute regarding the right to receive dividend;
- (d) where the dividend has been lawfully adjusted by the company against any sum due from the shareholder; or
- (e) where the delay is not due to default on the part of a company.

Where dividend is not paid or warrant have not been posted within 30 days from the date of declaration to any shareholder entitled to the payment of the dividend, every director shall, if he is knowingly a party to the default, be punishable with simple imprisonment up to three years and shall also be liable to a fine up to Rs. 1,000 per day during which the default continues. The company shall also be liable to pay interest at 18% per annum for the period of default.

Once a dividend warrant is posted at the registered address of the shareholder, it is deemed to have been paid within the meaning of section 205A. The section made failure to post the warrant, and not its non-receipt by the shareholder is an offence. The obligation to pay the dividend would be discharged when either is done.

The registered holder may ask the company to send the dividend to his banker or to any other person, which the company is bound to honour. In the case of joint holding if the dividend is payable to a person other than the registered holder, such a request shall be signed by all the holders.

Closure of Register of members

A company may close the Register of members for the purpose of ascertaining who are eligible to receive dividend on the date of declaration of dividend. In case of the annual dividend, the persons who are members as on the date of the annual general meeting will be eligible to receive the dividend as the dividend is approved by the members on the day when annual general meeting is held.

Dividend to be kept in abeyance in respect of pending of registration of transfer of shares lodged with the company

Section 206A provides that where valid transfer deed has been lodged with the company which has not been registered by the company, it shall withhold payment of the dividend on such shares till the shares are registered. This section does not apparently apply to a transfer, which has been refused.

But where the rejection is on account of reasons like difference in signature, insufficient stamp, etc., it will be desirable for the company to wait and keep in abeyance the dividend till the irregularity is removed to enable the company to register the transfer and pay the dividend to the transferee.

Opening of a separate bank account for making payment of dividend and deposit the amount of dividend into the account within a period of 5 days of its declaration

Section 205A state that the amount of dividend including interim dividend shall be deposited in a separate bank account within five days from the date of such declaration. Therefore, a company cannot use the amount even up to the period of thirty days and it is

obligatory on the part of the company to keep the entire amount of the dividend into a separate bank account, which shall be exclusively utilised for payment of the dividend.

A company which has declared dividend must open an account in a scheduled bank and transfer the entire net amount of dividend to the above account within 5 days from the date of declaration and simultaneously should dispatch the dividend warrants to the shareholders and should not wait for 37 (30+7) days to transfer the amount to that account.

INTERIM DIVIDEND

1. Interim dividend

Dividend includes any interim dividend. Before declaration of interim dividend, it is legal obligation on the Board of directors of the company to satisfy that the financial position of the company is sound enough for declaration of dividend out of net profit of the company available for distribution after providing for depreciation and making the mandatory transfer of profits to reserves.

2. The Articles must provide power to pay Interim dividend

The Articles of the company must authorise the Board to declare interim dividend. Regulation 86 of Table 'A' provides that the Board may from time to time pay to the members such Interim dividend as appear it to be justified by the profit of the company. Where there is no power in the articles authorising the Board to pay interim dividend, the only way open to the company is to pay dividend after the same is declared at the annual general meeting. Even in respect of the latter the Articles must contain the provision therefor.

3. Interim dividend should be declared by the Board at the meeting

A Board meeting should be called and rate at which dividend payable must be specifically stated in the resolution passed for declaration of interim dividend.

Declaration of interim dividend by directors does not create a debt; but declaration of dividend at a general meeting of company does.

4. Amount of Interim dividend must be transferred to a separate bank account and payment must be paid within 5 days

Interim dividend declared by the Board of directors of the company shall be transferred to the separate bank account within 5 days of such declaration and the amount so transferred shall not be utilised for any other purpose. The Interim dividend shall also be paid within thirty days from the date of its declaration by the Board.

5. Mode of payment of Interim dividend

Interim dividend shall be payable in cash and may be paid by cheque or warrant sent through the post direct to the registered address of the shareholder entitled to the payment of Interim dividend, or in the case of joint shareholders, to the registered address of that one of the joint shareholders who is first named on the register of members, or to such person and to such address as the shareholders or the joint shareholders may in writing direct.

6. Transfer of unpaid/unclaimed Interim dividend to the Investor Education and Protection Fund

The provisions of sections 205A and 205C shall also apply to the Interim dividend which provides that any amount of unpaid or unclaimed dividend shall be transferred after 7 years to the Investor Education and Protection Fund established by the Central Government as dividend includes Interim dividend, the company will have to comply with the provision of said sections in respect of Interim dividend.

7. Revocation of Interim dividend cannot be made

Section 2(14A) provides that the dividend includes interim dividend, therefore, once it has been declared and communicated, it shall become a debt for a company and cannot be revoked by the Board of directors after its declaration.

8. Approval of members at the general meeting for Interim dividend

If the Interim dividend is approved by the Board of directors, the amount of Interim dividend shall be included in the profit and loss account for the year and also in the directors' report alongwith the final dividend, if any, proposed for the approval of the members at the forthcoming annual general meeting. When the audited accounts and directors' report are placed at the annual general meeting and adopted by the members, the interim dividend is deemed to have been approved by the company in general meeting.

Approval of dividend is the privilege of the general meeting and the Board can pay interim dividend if so authorised by the Articles of Association subject to the regularisation of the interim dividend by the company in general meeting. The general meeting for this purpose shall be an annual general meeting only, for the profit for the financial year would not otherwise be known. [Letter No. 8/13/(205)/79-CL-V, dated 18-7-1981].

FINAL DIVIDEND

1. Declaration of dividend is an ordinary business

Section 173(1)(a)(ii) provides that the declaration of a dividend is an ordinary business to be transacted at an annual general meeting.

2. Declaration of dividend at an extraordinary general meeting — whether permissible

If the Articles of a company permits the declaration of dividend at an extraordinary general meeting, it will not be considered *ultra vires*. A company which could not declare a dividend at an annual general meeting can declare dividend at the ensuing general meeting. But if a company had declared final dividend at an annual general meeting, the company cannot declare further dividend for the same year.

3. Declaration of dividend for previous years is not permissible

A company cannot declare dividend for the past years or with retrospective effect after closing of the respective year's accounts and adoption by members in annual general meeting for that year.

4. Recommendation of dividend by the Board

The Board of directors of a company shall recommend in the directors' report the rate of dividend and the amount, if any, which should be paid by way of dividend. [Section 217(1)(c)]

5. Withdrawal of recommendation of dividend

The recommendation of dividend by directors is merely a proposal and it can be rescinded before it is included in the notice of annual general meeting sent to members of the company. Recommendation of dividend by Board of directors for declaration at the ensuing annual general meeting of the company is not a debt enforceable against the company.

Dividend once declared at an annual general meeting becomes a debt due and enforceable against the company.

6. Revocation of final dividend declared by the members at a general meeting

Since, the declaration of dividend at a general meeting creates a debt enforceable against the company, it cannot be revoked even with the consent of the shareholders.

7. Payment of dividend out of reserves

Section 205A(3) of the Companies Act, 1956 read with the Companies (Declaration of Dividend out of Reserves) Rules, 1975 deals with the power of a company to declare dividend out of reserves.

In case of inadequacy or in the absence of profits in any year, if any company proposes to declare dividend out of the accumulated profits earned by the company in any previous years and transferred by it to the reserves, such declaration or dividend shall be made in accordance with the Companies (Declaration of Dividend out of Reserves) Rules, 1975. The company must observe the following conditions in such case:—

- (i) There is either absence or inadequacy of profits in the year for which dividend is proposed to be declared.
- (ii) The rate of the dividend declared shall not exceed the average of the rates at which dividend was declared by it in the five years immediately preceding that year or 10% of its paid-up capital, whichever is less.
- (iii) The total amount to be drawn from the accumulated profits earned in previous years and transferred to the reserves shall not exceed an amount equal to 1/10th of the sum of its paid up capital and free reserves and the amount so drawn shall first be utilised to set off the losses incurred in the financial year before any dividend in respect of preference or equity shares are declared.
- (iv) The balance of reserves after such drawal shall not fall below 15% of its paid-up share capital.

8. Requirement for compulsory transfer of certain percentage of profit to reserves for declaring dividend

A company may declare or pay dividend for any financial year out of the profits of the company for that financial year arrived at after providing depreciation as per section 205(2) provided it transfers to its reserves prescribed percentage (not exceeding 10%) of the profits.

SECRETARIAL STANDARDS ON DIVIDEND

The Institute of Company Secretaries of India has issued SS-3 namely Secretarial Standards on dividend, which apply to interim as well as final dividend of a company.

COMPANIES (TRANSFER OF PROFITS TO RESERVES) RULES, 1975

In exercise of the powers conferred by sub-section (2A) of section 205, read with clause (a) of sub-section (1) of section 642 of the Companies Act, 1956 (1 of 1956), the Central Government hereby makes the following Rules, namely:—

1. Short title.—These Rules may be called the Companies (Transfer of Profits to Reserves) Rules, 1975.

2. Percentage of profits to be transferred to reserves.—No dividend shall be declared or paid by a company for any financial year out of the profits of the company for that year arrived at after providing for depreciation in accordance with the provisions of sub-section (2) of section 205 of the Act, except after the transfer to the reserves of the company of a percentage of its profits for that year as specified below.—

- (i) where the dividend proposed exceeds 10 per cent but not 12.5 per cent of the paid up capital, the amount to be transferred to the reserves shall not be less than 2.5 per cent of the current profits;
- (ii) where the dividend proposed exceeds 12.5 per cent, but does not exceed 15 per cent of the paid up capital, the amount to be transferred to the reserves shall not be less than 5 per cent of the current profits;
- (iii) where the dividend proposed exceeds 15 per cent, but does not exceed 20 per cent of the paid up capital, the amount to be transferred to the reserves shall not be less than 7.5 per cent of the current profits; and
- (iv) where the dividend proposed exceeds 20 per cent of the paid up capital the amount to be transferred to reserves shall not be less than 10 per cent of the current profits.

3. Conditions governing voluntary transfer of a higher percentage.—Nothing in rule 2 shall be deemed to prohibit the voluntary transfer by a company of a percentage higher than 10 per cent of its profits to its reserves for any financial year, so however that.—

(i) Where a dividend is declared,—

- (a) a minimum distribution sufficient for the maintenance of dividends to shareholders at a rate equal to the average of the rates at which dividends declared by it over the three years immediately preceding the financial year; or
- (b) in a case where bonus shares have been issued in the financial year in which the dividend is declared or in the three years immediately preceding the financial year, a minimum distribution sufficient for the maintenance of dividends to shareholders at an amount equal to the average amount (quantum) of dividend declared over the three years immediately preceding the financial year, is ensured:

Provided that in a case where the net profits after tax are lower by 20 per cent, or more than the average net profits after tax of the two financial years immediately preceding, it shall not be necessary to ensure such minimum distribution.

- (ii) Where no dividend is declared, the amount proposed to be transferred to its reserves from the current profits shall be lower than the average amount of the dividends to the shareholders declared by it over the three years immediately preceding the financial year.

4. Penalty.—If a company fails to comply with any of the provisions contained in these Rules, the company and every officer of the company in default shall be punishable with fine which may extend to five hundred rupees, and, where the contravention is a continuing one, with a further fine which may extend to fifty rupees for every day, after the first, during which such contravention continues.

COMPANIES (DECLARATION OF DIVIDEND OUT OF RESERVES) RULES, 1975

In exercise of the powers conferred by sub-section (3) of section 205A, read with clause (a) of sub-section (1) of section 642 of the Companies Act, 1956 (1 of 1956), the Central Government hereby makes the following Rules, namely:—

1. Short title.—These Rules may be called the Companies (Declaration of Dividend out of Reserves) Rules, 1975.

2. Declaration of dividend out of reserves.—In the event of inadequacy or absence of profits in any year, dividend may be declared by a company for that year out of the accumulated profits earned by it in previous years and transferred by it to the reserves, subject to the conditions that—

- (i) the rate of dividend declared shall not exceed the average of the rates at which dividend was declared by it in the five years immediately preceding that year or ten per cent of its paid up capital, whichever is less;
- (ii) the total amount to be drawn from the accumulated profits earned in previous years and transferred to the reserves shall not exceed an amount equal to one-tenth of the sum of its paid up capital and free reserves and the amount so drawn shall first be utilised to set off the losses incurred in the financial year before any dividend in respect of preference or equity shares is declared;
- (iii) the balance of reserves after such drawal shall not fall below fifteen per cent of its paid up share capital;
- [(iv) the Forms prescribed in these rules may be filed through electronic media or through any other computer readable media as preferred under section 610A of the Companies Act, 1956;
- (v) the electronic form shall be authenticated by the authorized signatories using digital signatures, as defined under the Information Technology Act, 2000 (21 of 2000);
- (v) the Forms prescribed in these rules, when filed in physical form, may be authenticated by authorized signatory by affixing his signatures manually.]³

Explanation.—For the purposes of this rule, "profits earned by a company in previous years and transferred by it to the reserves" shall mean the total amount of net profits after tax, transferred to reserves as at the beginning of the year for which the dividend is to be declared; and in computing the said amount, the appropriations out of the amount transferred from the Development Rebate Reserve at the expiry of the period specified

under the Income-tax Act, 1961 (43 of 1961) shall be included and all items of capital reserves including reserves created by revaluation of assets shall be excluded.

The rates of compulsory transfer of profits to reserves have been furnished in rule 2 of the Companies (Transfer of Profits to Reserves) Rules, 1975.

TRANSFER OF UNPAID OR UNCLAIMED DIVIDEND

Unpaid or unclaimed dividend

Section 205A(1), *inter alia*, provides that where dividend has been declared by a company but has not been paid or unclaimed or which remains unpaid within thirty days from the date of the declaration to any shareholder entitled thereto, such dividend is called unpaid or unclaimed dividend. *Explanation* to section 205A(1) states that the expression "dividend which remains unpaid" means any dividend the warrant in respect thereof has not been encashed or which has otherwise not been paid or claimed. It has been further clarified by the Department that the two expressions 'has not been paid' and 'the warrant in respect thereof has not been posted' used therein are used to denote two separate contingencies and hence the provisions thereof do not apply to a case where company has posted dividend warrant within 30 days from the date of declaration of dividend but the dividend warrant has not been encashed within the period of 7 days after the expiry of the 30 days. [Circular No. 28/76, dated 1-9-1976].

Time-limit for transfer of unpaid dividend to special dividend account

Section 205A(1) provides that the company shall, within seven days of the date of expiry of period of thirty days from the date of declaration of dividend, transfer such unpaid or unclaimed dividend to a special account. The special account will be called as unpaid dividend account of M/s. Co. Ltd./Pvt. Ltd. and is to be opened by the company in a scheduled bank.

Penalty for failure in transferring unpaid dividend to unpaid dividend account

Section 205A(4) contains provisions as to penalty for default in transferring unpaid or unclaimed dividend to unpaid dividend account. Accordingly, the company shall pay interest @ 12% p.a. on so much of amount of unpaid or unclaimed dividend which has not been transferred to unpaid dividend account. Such interest shall be paid from the date of the default and benefit of such interest shall accrue to shareholders in proportion to the amount remaining unpaid to them.

Transfer of unpaid dividend to Investor Education and Protection Fund

As per sub-section (5) of section 205A any money transferred to unpaid dividend account of a Company which remains unpaid or unclaimed in the said account for a period of seven years from the date of such transfer is required to be transferred by the company to Investor Education and Protection Fund which has been established under section 205C.

Therefore, any shareholder who has not claimed the unpaid dividend may approach the company to issue duplicate dividend warrants and get their dividend within the period of seven years *plus* 37 days only.