

Dividends and Manner and Time of Payment There of (Sections 205 – 207)

Manner and time of payment

Question 1

The shareholders at an annual general meeting unanimously passed a resolution for payment of dividend at a rate higher than that recommended by the directors. Discuss the validity of the resolution.

Answer

Articles of companies usually contain provisions with regards to declaration of dividend on the pattern of regulations 85 to 94 of Table A of the Companies Act, 1956. Under the regulation 85, the power to declare a dividend vests with the general meeting, but it has no power to declare a dividend exceeding the amount recommended by the Board of Directors.

Transfer of higher percentage of profits to reserves

Question 2

Advise on the following situations:

- (i) *A company wants to transfer more percentage of profits to reserves.*
- (ii) *A company wants to declare dividends out of past reserves instead of current year profits.*
- (iii) *A company wants to provide depreciation higher than the rates provided in Schedule XIV.*

Answer

- (i) A company can make a transfer of more than 10% to reserves provided it ensures the minimum distribution specified in Rule 3 of the Companies (Transfer of Profits to Reserves) Rules, 1975.
 - (a) The minimum distribution is the rate of dividend equal to the average of the rates of dividend for the last 3 financial years.
 - (b) Where bonus shares have been issued during the financial year, minimum distribution would be the average of the amount of dividend for the last three financial years.
 - (c) Where, however, the net profits after tax for the financial year are lower by 20% or more than the average net profits after tax for the last two financial years, it

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will not be necessary to ensure the minimum distribution for making a higher transfer to reserve.

- (ii) Dividends may be declared out of the profits of the company for any previous financial year or years arrived at after providing for depreciation in accordance with Section 205 of the Companies Act, 1956. However, the Central Government may in the public interest relax the payment of the profits without providing for depreciation. The Companies (Declaration of Dividend out of reserves) Rules, 1975 provided that
- (iii) The rate of dividend declared does not exceed the average of the rates at which dividend was declared by it in the 5 years immediately preceding that year or 10% of its paid-up capital, whichever is less.
- (iv) The total amount to be drawn from the accumulated profits earned in previous years and transferred to the reserves does not exceed an amount equal to 1/10th of the sum of its paid-up capital and free reserves and the amount so drawn must first be utilized to set off losses incurred in the financial year before any dividend in respect of preference or equity shares is declared.
- (v) The balance of reserves after such drawal does not fall below 15% of its paid-up capital.
- (vi) The rates contained in Schedule XIV are the minimum rates below which companies are not permitted to charge for depreciation and therefore there is no bar in providing a higher rate of depreciation.

Declaration of Dividend out of Past Reserves

Question 3

A Public Company has been declaring dividend at the rate of 20% on equity shares during the last 5 years. The Company has not made adequate profits during the year ended 31st March, 2009, but it has got adequate reserves which can be utilized for maintaining the rate of dividend at 20%. Advise the Company as to how it should go about if it wants to declare dividend at the rate of 20% for the year 2008-2009. Would your answer be different if the company utilized only the profits made in the previous years and retained in the profit and loss account for the purpose of payment of dividend at the rate of 20% for the year 2008-2009?
(November 2009)

Answer

As per Rule 2 of the Companies (Declaration of Dividend out of Reserves) Rules, 1975 dividend may be declared by a company for any year out of the accumulated profits earned by it previous years and transferred by it to the reserves subject to certain conditions. One of the conditions is that the rate of dividend declared shall not exceed the average of the rates at which dividend was declared by it in the 5 years immediately preceding that year or 10% of its paid-up capital which ever is less. As the proposed dividend exceeds 10%, it is necessary to seek the approval of the Central Government as required under section 205A(3) and only after obtaining the approval of the Central Government, the company may declare dividend at rate

of 20% for year 2008-09, even if the other conditions relating to the amount that can be drawn from the reserves and minimum balance in the reserve are fulfilled. However, the credit balance, if any, carried in the profit and loss account will be available for declaration of dividend without any restriction. Hence in such a case dividend may be declared at the rate of 20% for 2008-09, without approval of the Central Government.

Question 4

The agenda for the meeting of the Board of Directors of M/s Brilliant Enterprises Ltd. held on 20-3-2011 for adopting the annual accounts for the year ended 31-12-2010 included an item relating to payment of dividend. At the meeting it became apparent that the profits made during the year ended 31-12-2010 were inadequate to declare dividend. The Board was keen to maintain the rate of 20% dividend on the equity shares as declared in the previous years so as to maintain the image of the company. The company has some accumulated profits earned in previous years, which were transferred to reserves. Advise the company as to how it should go about to achieve the objective to pay dividend at the rate of 20% on the equity shares.
(May 2011)

Answer

Payment of Dividend out of the accumulated profits:

According to Section 205A (3) of the Companies Act, 1956, where, owing to inadequacy or absence of profits in any year, any company proposes to declare dividend out of the accumulated profits earned by the company in previous years and transferred by it to the reserves, such declaration of dividend shall not be made except in accordance with Companies (Declaration of Dividend out of Reserves) Rules, 1975, as may be made by the Central Government in this behalf and where any such declaration is not in accordance with such rules, such declaration shall not be made except with the previous approval of the Central Government.

According to the rules, dividend can be declared by the company out of accumulated profits subject to the following conditions;

1. The rate of the dividend declared does not exceed the average of the rates at which dividend was declared by it in the 5 years immediately preceding that year or 10 per cent of its paid up capital, whichever is less.
2. The total amount to be drawn from the accumulated profits earned in previous years and transferred to the reserves does not exceed an amount equal to 1/10th of the sum of its paid up capital and free reserves and the amount to drawn must first be utilized to set off the losses incurred in the financial year before any dividend in respect of preference or equity shares is declared.
3. The balance of reserves after such drawl does not fall below 15 per cent of its paid up share capital.

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Thus, in the present case, if M/s. Brilliant Enterprises Ltd. is not complying with the conditions mentioned in the Companies (Declaration of Dividend out of Reserves) Rules, 1975 then it is required to take previous approval of the Central Government for declaring dividend at the rate of 20% on the equity shares.

Declaration of interim dividend

Question 5

Board of Directors of M/s. RPP Ltd. in its meeting held on 29th May, 2009 declared an interim dividend payable on paid up Equity Share Capital of the Company. In the Board Meeting scheduled for 10th June, 2009, the Board wants to revoke the said declaration. You are required to state with reference to the provisions of the Companies Act, 1956 whether the Board of Directors can do so.
(May 2009)

Answer

Prior to the passing of Companies (Amendment) Act, 2000 only Regulation 86 of Table "A" to the Companies Act, 1956 dealt with the question of interim dividend. The said Regulation empowered the directors to declare interim dividend. i.e. dividend in between two annual general meetings. The said amending Act introduced sub-Section 14A in Section 2 of the Companies Act, 1956 whereby interim dividend is now part of dividend. Accordingly, all provisions of the Companies Act, 1956 relating to dividend have become applicable to interim dividend also.

Section 205 of the Companies Act, 1956 has also been amended by the said amending Act to provide as follows:

- (i) The Board of Directors may declare interim dividend and the amount of dividend including interim dividend shall have to be deposited in a separate bank account within five days from the date of declaration of such dividend. [Section 205(1A)]
- (ii) The amount of interim dividend so deposited as stated above shall be used for payment of interim dividend. [Section 205(1B)]
- (iii) The provisions of Sections 205, 205A, 205C, 206, 206A, and 207 of the Companies Act, 1956 have also become applicable to interim dividend to the extent possible. [Section 205(1C)]

In view of the above legal position, the Board of Directors of RPP Ltd. must have deposited the amount of interim dividend declared on 29th May, 2009 into a separate bank account on or before 3rd June, 2009 i.e. within five days from 29th May, 2009 when the interim dividend was declared. As stated above, the amount once deposited into a separate bank account, can be used only for payment of interim dividend.

As per provisions of the Companies Act, 1956, the Board of RPP Ltd. has no power to revoke the interim dividend declared on 29th May, 2009 and shall not have any power to use the interim dividend amount transferred to a separate bank account for any other purpose.

In case the amount of interim dividend has not been transferred to a separate bank account and is not paid within the time, the company and its directors have exposed themselves to the applicable penal provisions of the said Act.

Question 6

SKD an employee of M/s Moreh Ltd. met with an accident and died. The accident occurred when SKD was on Company's duty. He held one hundred S shares partly paid. Normally the Company has a first and paramount lien on the shares. The Board of Directors, however, relaxed the said provision with regard to the hundred shares held by SKD as a goodwill gesture on the part of the Company. Is the action of the Company valid? State the reasons. Also state whether the Company's lien can be extended to dividend payable on such shares. (November 2009)

Answer

A Company cannot have lien on shares unless provided in the Articles of Association. Therefore provision to this effect should be in the articles. As per Regulation 9 of Table A of the Companies Act, 1956 the Company has first and paramount lien on every share (which has not been fully paid up for all monies (whether presently payable or not) called or payable at a fixed time in respect of that share and on all shares which are not fully paid up standing registered in the name of a single person, for all moneys presently payable by him or his estate to the Company.

The Board of Directors may, however, at any time declare any share to be wholly or in part exempt from the said provision. Hence the decision of the Board of Directors of M/s Moreh Ltd to relax the provisions of lien in respect of shares held by SKD is in order and valid (Vide Regulation 9 of Table A). Further the Company's lien is extended to all dividends payable on such shares as per regulation 9(2) of table A of the Companies Act, 1956.

Exercise

Question 1

The agenda for the meeting of the Board of Directors of M/s. Packsafe Enterprises Ltd. held on 20-3-2010 for adopting the annual accounts for the year ended 31-12- 2009 included an item relating to payment of dividend. At the meeting it became apparent that the profits made during the year ended 31-12-2009 were inadequate to declare dividend. The Board was keen to maintain the rate of 20% dividend on the equity shares as declared in the previous years so as to maintain the image of the company. The company has some accumulated profits earned in previous years, which were transferred to reserves. Advise the company as to how it should go about to achieve the objective to pay dividend at the rate of 20% on the equity shares.

Answer

Dividends out of past profits/reserves can be declared as per the Companies (Declaration of dividend out of Reserves) Rules, 1975. These Rules, inter alia, provide that the dividends to

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be declared out of reserves shall not exceed average of dividends declared during the last 5 years or 10% of its paid up capital whichever is less. Since, in the present case, it is proposed to declare dividend @ 20%, it shall not be possible without previous approval of the Central Government as per section 205A (3). The company is advised to make an application to the Central Government, seeking approval for payment of dividend at 20%. It is presumed that the paid-up capital of the company consists of only equity share capital.