

16. Divisible Profits and Dividends

Definition

- **Definition of Dividend:** includes any interim dividend. Therefore all the provisions applicable to final dividend shall apply to interim dividend.
- **Meaning of Dividend:** dividend is a return on the investment of shareholders in a company. only profits can be distributed as dividend. Issue of bonus share by capitalising the profit is not amount to dividend.
- **Declaration of dividend:**
 - ✓ The power of declare dividend is rests with the members, but the members ca exercise such power only if the dividend is proposed by the board.
 - ✓ The rate of dividend proposed by the board may be reduced by the members.
 - ✓ The rate of dividend proposed by the board can not be increased by members.
 - ✓ Any provision in the articles, which authorise the members to declare dividend higher than the rate recommended by board, is void.
 - ✓ The board has no power to declare dividend, its power are limited to recommendation of dividend.

Preference dividend vis-a-vis equity dividend

- Dividend of PS is paid on a fixed rate, or alternatively preference shareholders have a right to receive fixed amount of dividend in every FY.
- In case of cumulative preference shares, arrears of dividend in respect of past FY as well as preference dividend for current year must be paid in the current FY before any dividend is paid on equity share.
- Payment of arrears of dividend in winding up
 - ✓ If dividend of any year is declared before the commencement of winding up, such dividend result in a debt owed to the shareholders by the company. Therefore, The company shall be liable to pay such dividend, whether or not there is any provision to that affect in the articles.
 - ✓ If dividend for any year is not declared before the commencement of winding up, the company shall not be liable to pay such dividend, unless there is a provision to that effect in the articles.
 - ✓ If any surplus remains after repayment in full of preference and equity share capital, the company shall be liable to pay dividend for every year for which no dividend was declared, whether or not there is any provision to that effect in the articles.

Condition for declaration and payment of dividend (Section 205)

- Sources of dividend
 - ✓ Profits of current FY
 - ✓ Undistributed profits of previous financial years;
 - ✓ Moneys provided by the CG or SG in pursuance of a guarantee given by it.
- Provisions for depreciation
 - ✓ Profits of every financial year shall be arrived at after providing for depreciation.
 - ✓ The CG may allow to declare dividend from profit before allowing depreciation if it in a public interest.

- ✓ If in any previous FYs depreciation is not provided, than it shall be provided before any dividend is declared for the current FY.

➤ Set off of past losses

Lowest of the

- ✓ Amount of past losses (after depreciation)
- ✓ The amount of depreciation that year

FY	PBD	Depreciation	PAD	Set off amount
2011-12	20000	43000	(14000)	(14000)
2012-13	(20,000)	34000	(54000)	34000

➤ Transfer to reserve

Rate of proposed dividend on paid up capital	Minimum percentage of CY's profit to be transferred to reserve
Up to 10%	Nil
Exceeds 10% but not 12.5%	2.5% of current year's profit
Exceeds 12.5% but not 15%	5% of current year's profit
Exceeds 15% but not 20%	7.5% of current year's profit
Exceeds 20%	10% of current year's profit

'Rate of proposed dividend' mentioned above refers to

- ✓ Equity dividend
- ✓ Part of dividend which participating preference shareholders are entitled to, after receiving their fixed percentage of dividend.

The reserve does not include capital reserve or any other reserve created by revaluation.

- As per Act, a company may voluntary transfer a percentage higher than 10% of its profits to reserve for any FY.
- A company which fails to redeem its *irredeemable preference share* shall not, so long as such failure continues, declare any dividend on its equity share.
- Once a company has declared dividend, it is obligatory to pay such dividend in cash, or by issue of a cheque or dividend warrant. But issue of bonus share in lieu of declared dividend is not permissible.
- The dividend shall be deposited in a separate bank account within 5 days of declaration of dividend.

Charging depreciation for the purpose of payment of dividend

- The rate of depreciation must be the rate specified in scheduled XIV or a rate higher than that specified in such schedule.
- Amount
 - ✓ At WDV or SLM, option of company
 - ✓ Such an amount shall be charged as depreciation as is arrived at by dividing 95% of the original cost of the asset by that specified period.
- Mandatory to charge depreciation
 - ✓ Depreciation must be charged on all depreciable assets owned by the company, irrespective of the fact as to whether some asset was put to use or not.

- ✓ Depreciation shall be charges at 100% in resects of assets costing less than Rs. 5,000. However, of the aggregate actual cost of individual items of P & M costing Rs. 5000 or less constitutes more than 10% of the total cost of P & M, ordinary depreciation arte will be applicable to all such items of P & M.
- ✓ Depreciation shall be provided on pro-rate basis where an asset purchased or sold during the year.

Unpaid dividend and Investor education and Protection fund

- Treatment of dividend declared but remaining unpaid
 - ✓ Transferred to unpaid dividend account: dividend remaining unclaimed *within 30 days* form declaration shall be transferred *within 7 days* to Unpaid dividend account or...company.
 - ✓ Interest rate of 12% is applicable if company delay in transfer such amount.
- Treatment of dividend remaining unpaid in 'unpaid dividend account'
 - ✓ Any money transferred which remains unpaid for 7 years from the date of such transfer shall be transferred by the company to the 'Investor education and Protection fund' (shall be referred as 'fund')
 - ✓ On transfer of unpaid dividend to the fund, the company shall be discharged of all its liabilities in respect of unpaid dividend so no person shall be entitle to claim such dividend from company.

Payment of dividend to whom? (Section 206)

- The registered shareholder; or
- The order of the registered shareholder; or
- The bankers of the registered shareholder; or
- The bearer of the share warrant.

Failure to distribute dividend within 30 days (Section 207)

- Time limit
 - ✓ Within 30 days
- Exceptions
 - ✓ Where dividend could not be paid by reason of the operation of any law.
 - ✓ Where a shareholder has given directions to the company regarding payment of dividend, but that direction cannot be complied with.
 - ✓ Where dividend is lawfully adjusted by the company against any sum due to it from the shareholder.
 - ✓ Where there is a dispute regarding the right to receive the dividend.
 - ✓ Where the non-payment of dividend is not due to any default of the company.
- Penalty for non-payment
 - ✓ Every director – imprisonment up to 3 years and a fine of Rs. 1,000/Day
 - ✓ Company – 18% per annum interest during the period of default.

Revocation of dividend

- Revocation of dividend is not possible
- Exception
 - ✓ Where declaration of dividend is *ultra vires*, the declared dividend can be revoked. However, if illegally declared dividend is paid, the directors shall be liable to indemnify the company.
 - ✓ Where the company ceases to be a going concern, declared dividend may be revoked.

Consequences of payment of dividend out of capital

- The directors who knowingly paid dividend out of capital shall be held personally liable to make good the loss cause to company.
- The directors have a right to indemnify against the members who received the dividends knowing that the dividend was being paid out of capital.
- Where dividends improperly paid out of capital have been made good out of subsequent profits, liability ceases to attach the directors.

Declaration of dividend out of reserves

- can be declared out of the profits transferred to reserve only if-
 - ✓ Previous approval of CG is obtained
 - ✓ As per the rules prescribed by the CG and companies act. (rules are as per below)
- Rules
 - ✓ Rate of dividend: not exceeds the *lower of*
 - Average of the rates of dividend declared by the company or immediately preceding 5 financial years;
 - 10%
 - ✓ Amount withdrawn from reserves
 - Not exceeds 1/10th of aggregate of paid up capital and free reserves.
 - Further, the amount so withdrawn shall be first utilised to set off the losses incurred in the FY, and the balance amount can only be utilised for the declaration of dividend.
 - ✓ The balance of reserve after such withdrawal shall not fall below 15% of paid up share capital.