1

Declaration and Payment of Dividend

1. Meaning of Dividend

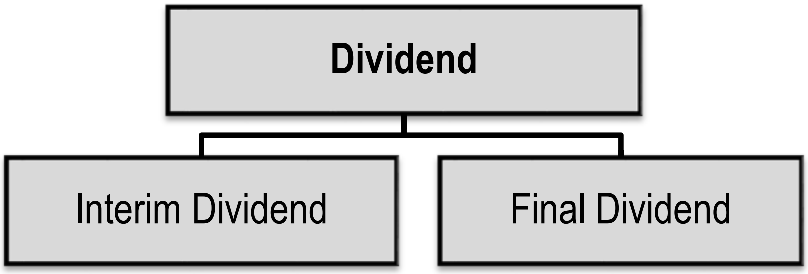
A dividend is a payment made by a company to its shareholders, usually as a distribution of profits i.e. a portion of profits earned and allocated as payable to the shareholders yearly or whenever declared.

A dividend is allocated as a fixed amount (generally in %) per share, with shareholders receiving a dividend in proportion to their shareholding.

Section 2(35) of the Companies Act, 2013, simply states that “dividend” includes any interim dividend.

2. Types of dividend

I. Dividend payable on the basis of Time (When declared)

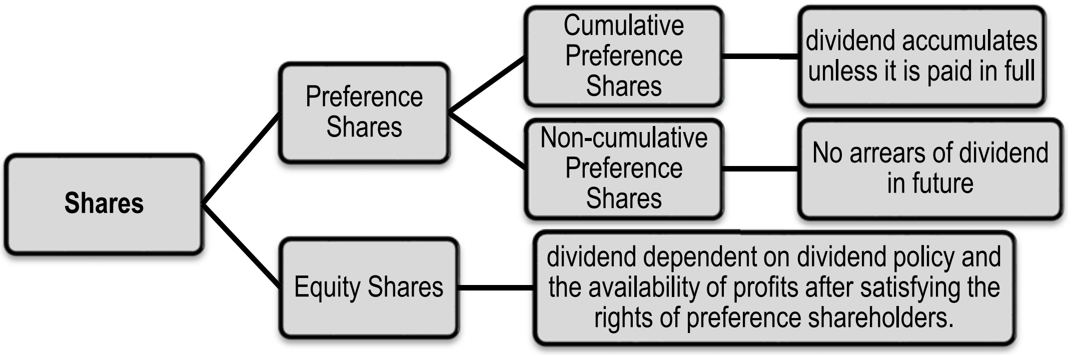


Interim Dividend: When the Board of Directors declare dividend between two annual general meetings of the company, such dividend is known as Interim dividend.

Final Dividend: When the dividend is declared at the annual general meeting of the company, it is known as Final dividend.

All the provisions applicable on dividend are also applicable on interim dividend.

II. Dividend payable on the basis of Nature of shares



Shares can be classified into two categories- Preference shares and equity shares. The manner of payment of dividend is dependent upon the nature of shares.

(i) Preference Shares: According to section 43 of the Companies Act, 2013 persons holding preference shares, called preference shareholders, are assured of a preferential dividend at a fixed rate during the life of the company.

Dividend is generally cumulative in nature and need not be paid every year in case of deficiency of profits.

Types of Preference Shares on the basis of payment of dividend

Preference shares' classification on the basis of payment of dividend is as follows:

(a) **Cumulative Preference Shares:** A cumulative preference share is one that carries the right to a fixed amount of dividend or dividend at a fixed rate. Such a dividend is payable even out of future profit if current year's profits are insufficient for the purpose. This means that dividend on these shares accumulates unless it is paid in full and, therefore, the shares are called Cumulative Preference Shares.

(b) **Non-cumulative Preference Shares:** A non-cumulative preference share carries with it the right to a fixed amount of dividend. In case no dividend is declared in a year due to any reason, the right to receive such dividend for that year expires. It implies that holder of such a share is not entitled to arrears of dividend in future.

(ii) Equity Shares: Equity shares are those shares, which are not preference shares. It means that they do not enjoy any preferential rights in the matter of payment of dividend or repayment of capital. The rate of dividend on equity shares is recommended by the Board of Directors and may vary from year to year. Rate of dividend depends upon the dividend policy and the availability of profits after satisfying the rights of preference shareholders.

3. Declaration of Dividend [Section 123]

According to this section:

(i) Dividend shall be declared or paid by a company for any financial year only—

(a) out of the profits of the company for that year arrived at after providing for depreciation in accordance with the provisions of section 123(2), or

(b) out of the profits of the company for any previous financial year or years arrived at after providing for depreciation in accordance with the provisions of that sub-section and remaining undistributed, or

[Note: Such depreciation shall be provided in accordance with the provisions of Schedule II.]

(c) out of both (a) and (b); or

(d) out of money provided by the Central Government or a State Government for the payment of dividend by the company in pursuance of a guarantee given by that Government.

(ii) Transfer 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. Therefore, the company may transfer such percentage of profit to reserves before declaration of dividend as it may consider necessary. Such transfer is not mandatory and the percentage to be transferred to reserves is to be decided at the discretion of the company.

Example 1: Alma limited proposes to transfer more than 10% of the profits of the company to the reserves for the current year, before the declaration of dividend @ 12%. Is Alma Limited allowed to do so?

Answer: The amount to be transferred to reserves out of profits for a financial year has been left at the discretion of the company acting vide its Board of Directors. Therefore, the company is free to transfer any part of its profits to reserves as it deems fit.

Example 2: Brix Limited has earned a profit of Rs. 1,000 crores for the financial year 2016-17. It has proposed a dividend @ 8.75%. However, it does not intend to transfer any amount to the reserves of the company out of the profits earned. Can Brix Limited do so?

Answer: The amount to be transferred to reserves out of profits for a financial year has been left at the discretion of the company acting vide its Board of Directors. The company is free to transfer any part of its profits to reserves as it deems fit. There is no restriction to transfer any specific amount (i.e. even no amount can be transferred) to the reserves before declaration of dividend.

(iii) Declaration of dividend out of accumulated profits: Where a company, owing to inadequacy or absence of profits in any financial year, proposes to declare dividend out of the accumulated profits earned by it in previous years and transferred by the company to the reserves, such declaration of dividend shall be made only in accordance with prescribed rules. [Second Proviso to section 123(1)]

Exemption: The above proviso shall not apply to a Government Company in which the entire paid up share capital is held by the Central Government, or by any State Government or Governments or by the Central Government and one or more State Governments.

(iv) Declaration of dividend from free reserves: Dividend shall be declared or paid by a company only from its free reserves. No other reserve can be utilized for the purposes of declaration of such dividend.

(v) Declaration of dividend by set off of previous losses and depreciation against the profit of the company for the current year: 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 for the current year.

For declaration of dividend out of accumulated profits, the Ministry of Corporate Affairs has provided Rule 3 of the Companies (Declaration and Payment of Dividend) Rules, 2014. Thereby, when there is inadequacy or absence of profits in any year, a company may declare dividend out of free reserves. However, the following conditions shall be fulfilled before declaring dividend out of reserves:

(a) The rate of dividend declared shall not exceed the average of the rates at which dividend was declared by it in the 3 years immediately preceding that year:

Rate of Dividend $\leq (RD_1 + RD_2 + RD_3)/3$ Where, RD_1, RD_2, RD_3 are rates at which dividend was declared by it in the 3 years immediately preceding that year.

However, **this rule will not apply** if a company has not declared any dividend in each of the 3 preceding financial years.

(b) 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.

Therefore,

Total amount that can be drawn from accumulated profits	≤	1/10 of (Paid up share capital + Free reserves)

(c) 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.

(d) The balance of reserves after such withdrawal shall not fall below 15% of its paid up share capital as appearing in the latest audited financial statement.

Example: A Public Company has been declaring dividend at the rate of 20% on equity shares during the last 3 years. The Company has not made adequate profits during the year ended 31st March, 2017, 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 2016-17, as per the provisions of the Companies Act, 2013.

Answer: In the given case, the company has made adequate profits for the current year. However, it can declare dividend out of accumulated profits. Hence, the company can declare a dividend of 20% provided it has the required residual reserve (after such payment) of 15% of its paid up capital and free reserves as appearing it its latest audited financial statement. The company should have the dividend recommended by the Board and put up for the approval of the members at the Annual General Meeting as the authority to declare dividend lies with the members of the company.

(vi) Depositing of amount of dividend: In terms of section 123(4), the amount of the dividend, including interim dividend, shall be deposited in a scheduled bank in a separate account within 5 days from the date of declaration of such dividend.

This sub-section shall not apply to a Government Company in which the entire paid up share capital is held by the Central Government, or by any State Government or Governments or by the Central Government and one or more State Governments or by one or more Government Company.

(vii) Interim Dividend:

According to section 123(3), 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.

However, 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.

If loss is there, Rate of Interim Dividend ≤ $(RD_1 + RD_2 + RD_3)/3$ Where, RD_1, RD_2, RD_3 are rates at which dividend was declared by it in the 3 years immediately financial years preceding that year.

The Board of directors may declare interim dividend and the amount of dividend including interim dividend shall be deposited in a scheduled bank in a separate bank account within 5 days from the date of declaration of such dividend.

Example: Wilson Limited is facing loss in business during the current financial year 2016-17. In the immediate preceding three financial years, the company had declared dividend at the rate of 8%, 10% and 12% respectively. To maintain the goodwill of the company, the Board of Directors has decided to declare 12% interim dividend for the current financial year. Is the act of Board of Directors valid?

Answer: 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 [i.e. (8+10+12)/3 =30/3=10%]. Therefore, decision of Board of Directors to declare 12% of the interim dividend for the current financial year is not tenable. They can declare a maximum 10% interim dividend.

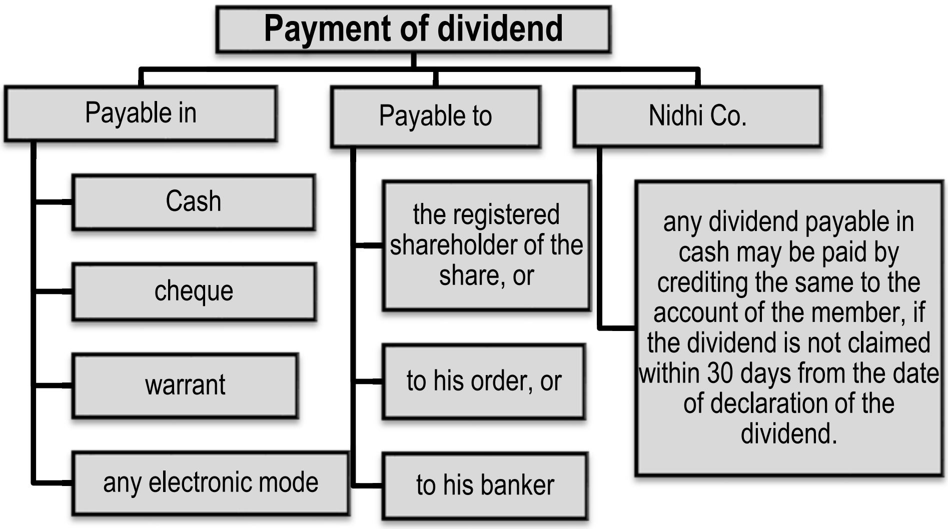
(viii) Payment of dividend: According to section 123(5):

(a) Dividends are payable in cash. Dividends that are payable to the shareholder in cash may be paid by cheque or warrant or in any electronic mode.

(b) Dividend shall be payable only to the registered shareholder of the share or to his order or to his banker.

(c) This sub-section shall apply to the Nidhis company, subject to that any dividend payable in cash may be paid by crediting the same to the account of the member, if the dividend is not claimed within 30 days from the date of declaration of the dividend.

(d) Nothing in sub-section 5 of section 123, shall prohibit the capitalization of profits or reserves of a company for the purpose of issuing fully paid-up bonus shares or paying up any amount for the time being unpaid on any shares held by the members of the company.



Example: The Director of Som Limited proposed dividend at 12% on equity shares for the financial year 2015-16. The same was approved in the annual general meeting of the company held on 20th September, 2016. The Directors declared the approved dividends.

Mr. Ninja was the holder of 1,000 equity shares on 31st March, 2016, but he has transferred the shares to Mr. Raj, whose name has been registered on 20th May, 2016. Who will be entitled to the above dividend.

Answer: According to section 123(5), dividend shall be payable only to the registered shareholder of the share or to his order or to his banker. Facts in the given case state that Mr. Ninja, the holder of equity shares transferred the shares to Mr. Raj whose name has been registered on 20th May 2016. Since, he became the registered shareholder before the declaration of the dividend in the Annual general meeting of the company held on 20th September 2016, so, Mr. Raj will be entitled to the dividend.

(ix) Prohibition on declaration of dividend: The Act by virtue of Section 123 (6) specifically provides that a company which fails to comply with the provisions of section 73 (Prohibition on acceptance of deposits from public) and section 74 (Repayment of deposits, etc., accepted before the commencement of this Act) shall not, so long as such failure continues, declare any dividend on its equity shares.

(x) Prohibition on section 8 companies : According to section 8(1), the companies having licence under Section 8 (Formation of companies with Charitable Objects, etc.] of the Act are prohibited from paying any dividend to its members. Their profits are intended to be applied only in promoting the objects of the company.

4. Unpaid Dividend Account [Section 124]

The provisions related to Unpaid Dividend Account are given under section 124 of the Companies Act, 2013, which are as follows:

(1) Declared dividend not paid or claimed to be transferred to the special account: Where a dividend has been declared by a company but has not been paid or claimed within 30 days from the date of the declaration to any shareholder entitled to the payment of the dividend, - the company shall, within 7 days from the date of expiry of the said 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 in any scheduled bank to be called the Unpaid Dividend Account.

(2) Preparing of statement of particulars of the unpaid dividend: The company shall, within a period of 90 days of making any transfer of an amount under sub-section (1) of section 124 to the Unpaid Dividend Account, prepare a statement containing the names, their last known addresses and the unpaid dividend to be paid to each person and place it on the web-site of the company, if any, and also on any other web-site approved by the Central Government for this purpose, in such form, manner and other particulars as may be prescribed.

(3) Default in transferring of amount: If any default is made in transferring the total amount referred to in section 124(1) or any part thereof to the Unpaid Dividend Account of the company,- it shall pay, from the date of such default, interest on so much of the amount as has not been transferred to the said account, at the rate of twelve per cent per annum and the interest accruing on such amount shall ensure to the benefit of the members of the company in proportion to the amount remaining unpaid to them.

(4) Apply for payment of claimed amount: Any person claiming to be entitled to any money transferred under section 124(1) to the Unpaid Dividend Account of the company may apply to the company for payment of the money claimed.

(5) Transfer of unclaimed amount to Investor Education and Protection Fund(IEPF): Any money transferred to the Unpaid Dividend Account of a company in pursuance of this section which remains unpaid or unclaimed for a period of 7 years from the date of such transfer shall be transferred by the company along with interest accrued, if any, thereon to the Fund established under section 125(1) and the company shall send a statement in the prescribed form of the details of such transfer to the authority which administers the said Fund and that authority shall issue a receipt to the company as evidence of such transfer.

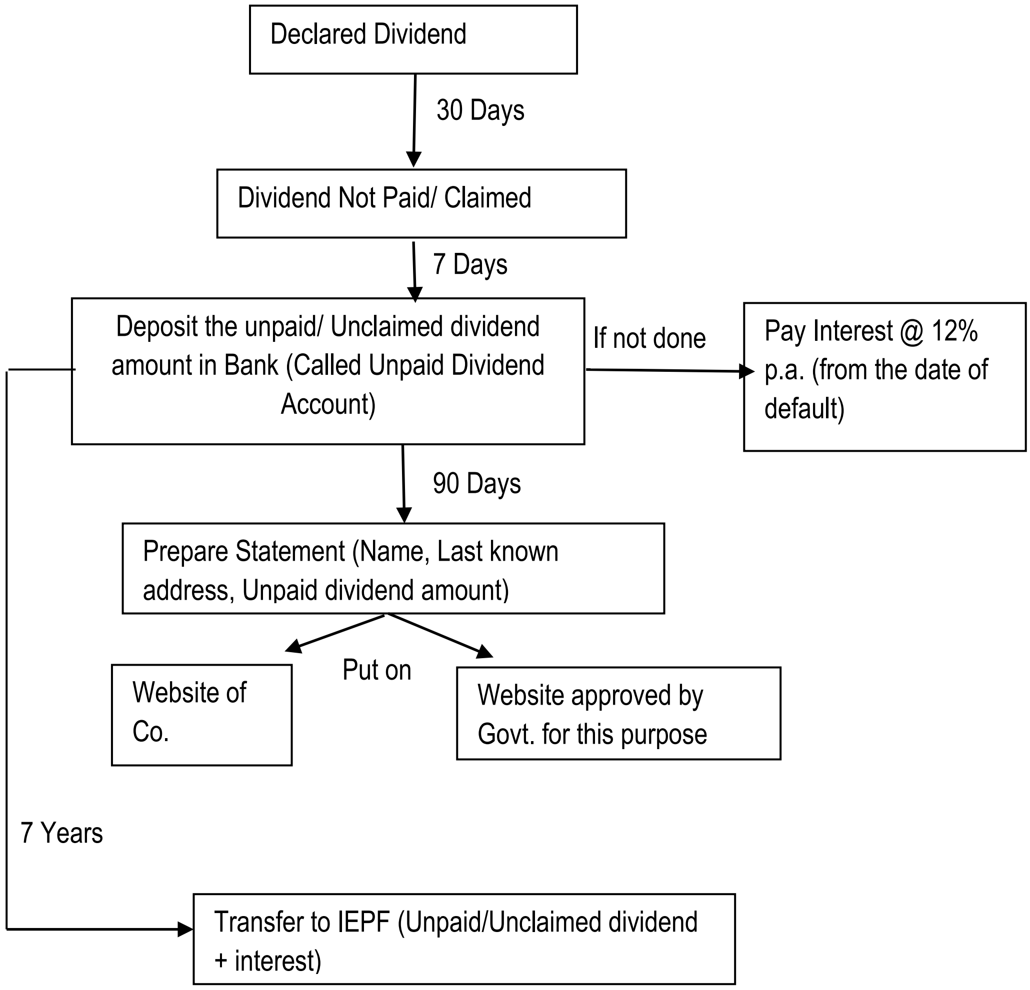
(6) Transfer of shares to IEPF: All shares in respect of which dividend has not been paid or claimed for 7 consecutive years or more shall be transferred by the company in the name of Investor Education and Protection Fund along with a statement containing such details as may be prescribed:

Right of owner of shares transferred to IEPF to claim from IEPF:

Provided that any claimant of shares transferred above shall be entitled to claim the transfer of shares from Investor Education and Protection Fund in accordance with such procedure and on submission of such documents as may be prescribed.

Explanation—For the removal of doubts, it is hereby clarified that in case any dividend is paid or claimed for any year during the said period of 7consecutive years, the share shall not be transferred to Investor Education and Protection Fund.

(7) In case of contravention: If a company fails to comply with any of the requirements of this section, the company shall be punishable with fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with fine which shall not be less than one lakh rupees but which may extend to 5 lakh rupees.



5. Investor Education and Protection Fund [Section 125]

Section 125 of the Act deals with the Investor Education and Protection Fund (IEPF).This fund shall be utilized for refund of unclaimed and unpaid amounts, promotion of investors' awareness and protection of the interests of investors etc. in accordance with provisions of section 125 of the Companies Act, 2013. Provisions given are as follows:

(1) Establishment of Fund: The Central Government shall establish a Fund to be called the Investor Education and Protection Fund (herein referred to as the Fund.

(2) Credit of amount to the Fund: There shall be credited to the Fund the following amounts—

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

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

(d) **Amount of the general revenue account of the Central Government-** the amount in the general revenue account of the Central Government which had been transferred to that account under section 205A(5) of the Companies Act, 1956 as it stood immediately before the commencement of the Companies (Amendment) Act, 1999 and remaining unpaid or unclaimed on the commencement of this Act;

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

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

(g) **Amount received through disgorgement or disposal of securities-** The amount received under section 38(4) i.e. amount received through disgorgement or disposal of securities under section 38(3) shall be credited to the IEPF provided under section 38(4);

(h) **Application money-** the application money received by companies for allotment of any securities and due for refund;

(i) **Matured deposits-** matured deposits with companies other than banking companies;

(j) **Matured debentures-** matured debentures with companies;

(k) **Interest-** interest accrued on the amounts referred to in clauses (h) to (j);

(l) **Amount received from sale proceeds-** sale proceeds of fractional shares arising out of issuance of bonus shares, merger and amalgamation for seven or more years;

(m) **Redemption amount-** redemption amount of preference shares remaining unpaid or unclaimed for seven or more years; and

(n) **Other amount-** such other amount as prescribed in Rule 3 of the Investor Education and Protection Fund Authority (Accounting, Audit, Transfer and Refund) Rules, 2016.

Exception- Provided that no such amount referred to in clauses (h) to (j) shall form part of the Fund unless such amount has remained unclaimed and unpaid for a period of 7 years from the date it became due for payment.

(3) Utilization of the Fund: The Fund shall be utilised 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,

in accordance with such rules as prescribed under the Investor Education and Protection Fund Authority (Accounting, Audit, Transfer and Refund) Rules, 2016.

Provided that the person whose amounts referred to in clauses (a) to (d) of sub-section (2) of section 205C transferred to IEPF, after the expiry of the period of 7 years as per provisions of the Companies Act, 1956, shall be entitled to get refund out of the fund in respect of such claims in accordance with rules made under this section.

Explanation.—The disgorged amount refers to the amount received through disgorgement or disposal of securities.

(4) Application to the authority for payment: Any person claiming to be entitled to the amount referred in section 125 (2) may apply to the authority constituted under section 125 (5) for the payment of the money claimed.

(5) Constitution of authority for administration of Fund: The Central Government shall constitute, by notification, an authority for administration of the Fund consisting of a chairperson and such other members, not exceeding seven and a chief executive officer, as the Central Government may appoint.

(6) Handling of the Fund: The manner of administration of the Fund, appointment of chairperson, members and chief executive officer, holding of meetings of the authority shall be in accordance with such rules as may be prescribed under the Investor Education and Protection Fund Authority (Appointment of Chairperson and Members, holding of meetings and provision for offices and officers) Rules, 2016.

(7) Providing of resources from central government to administer the Fund: The Central Government may provide to the authority such offices, officers, employees and other resources in accordance with the *Investor Education and Protection Fund Authority (Appointment of Chairperson and Members, holding of meetings and provision for offices and officers) Rules, 2016*.

(8) Authority to work in consultation with CAG of India: The authority shall administer the Fund and maintain separate accounts and other relevant records in relation to the Fund in such form as may be prescribed after consultation with the Comptroller and Auditor-General of India.

(9) Right of the authority to spend the money: It shall be competent for the authority constituted under section 125 (5) to spend money out of the Fund for carrying out the objects specified in section 125 (3) i.e. utilization of fund.

(10) Audit of the Fund: The accounts of the Fund shall be audited by the Comptroller and Auditor- General of India at such intervals as may be specified by him and such audited accounts together with the audit report thereon shall be forwarded annually by the authority to the Central Government.

(11) Preparation of the annual report by authority: The authority shall prepare in such form and at such time for each financial year as may be prescribed its annual report giving a full account of its activities during the financial year and forward a copy thereof to the Central Government and the Central Government shall cause the annual report and the audit report given by the Comptroller and Auditor-General of India to be laid before each House of Parliament.

6. Right of dividend, Rights shares and Bonus shares to be held in abeyance pending registration of transfer of shares [Section 126]

Where any instrument of transfer of shares has been delivered to any company for registration and the transfer of such shares has not been registered by the company, the company shall —

(a) transfer the dividend in relation to such shares to the Unpaid Dividend Account referred to in section 124 unless the company is authorised by the registered holder of such share in writing to pay such dividend to the transferee specified in such instrument of transfer; and

(b) keep in abeyance in relation to such shares any offer of rights shares under clause (a) of sub-section (1) of section 62 and any issue of fully paid-up bonus shares in pursuance of first proviso to sub-section (5) of section 123.

7. Punishment for failure to distribute dividends [Section 127]

Section 127 of the Companies Act, 2013 deals punishment for failure to distribute dividend on time. According to this section:

(i) 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 declaration to any shareholder entitled to the payment of the dividend, every director of the company shall, if he is knowingly a party to the default, be punishable with imprisonment which may extend to two years.

(ii) He shall also be liable for a fine which shall not be less than 1,000 rupees for every day during which such default continues.

(iii) The company shall also be liable to pay simple interest at the rate of 18% p.a. during the period for which such default continues.

(iv) However, the following are the exceptions under which no offence shall be deemed to have been committed:

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

   (b) where a shareholder has given directions to the company regarding the payment of the dividend and those directions cannot be complied with and the same has been communicated to him;

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

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

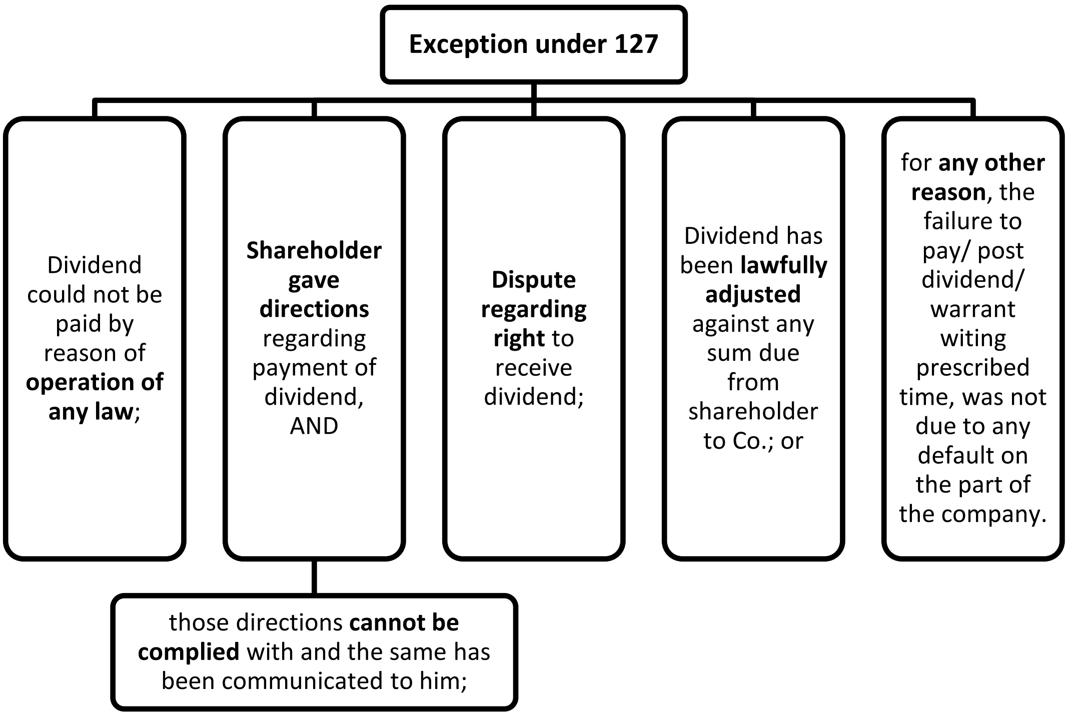
   (e) where, for any other reason, the failure to pay the dividend or to post the warrant within the period under this section was not due to any default on the part of the company.

Exemption : This section shall apply to the Nidhis company, subject to that where the dividend payable to a member is 100 rupees or less, it shall be sufficient compliance of the provisions of the section, if the declaration of the dividend is announced in the local language in one local newspaper of wide circulation and announcement of the said declaration is also displayed on the notice board of the nidhis for at least 3 months.

Example: Mr. Alok, holding equity shares of face value of ₹ 10 lakhs has not paid an amount of ₹ 1 lakh towards call money on shares. Can the same be adjusted against the dividend amount payable to him?

Answer: Yes, as per law, where the dividend is declared by a company and there remains calls in arrears and any other sum due from a member, in such case the dividend can be lawfully adjusted by the company against any sum due to it from the shareholder.

Thus, company can adjust sum of ₹ 1 lakh due towards call money on shares against the dividend amount payable to Mr. Alok.



RELEVANT AMENDMENTS

Amendments through the Companies (Amendment) Act, 2017

Relevant sections	Amendment	Status
Amendment of section 123	In section 123 of the principal Act,— (*a*) in sub- section (*1*),— (*i*) in clause (*a*),— (*A*) for the words "both; or", the word "both:" shall be substituted; (*B*) the following proviso shall be inserted, namely:—	Notified till 30th April, 2018

	"Provided that in computing profits any amount representing unrealised gains, notional gains or revaluation of assets and any change in carrying amount of an asset or of a liability on measurement of the asset or the liability at fair value shall be excluded; or"; (*ii*) in the second proviso, for the words "transferred by the company to the reserves", the words "transferred by the company to the free reserves" shall be substituted; (*b*) for sub-section (*3*), the following sub-section shall be substituted, namely:— "(*3*) The Board of Directors of a company may declare interim dividend during any financial year or at any time during the period from closure of financial year till holding of the annual general meeting out of the surplus in the profit and loss account or out of profits of the financial year for which such interim dividend is sought to be declared or out of profits generated in the financial year till the quarter preceding the date of declaration of the interim dividend: 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 immediately preceding three financial years."	