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Declaration and Payment of Dividend

1.1 Meaning of Dividend

The literal meaning of the term ‘dividend’ stands for the sum payable as interest on loan or as share of profit to shareholders in a business of a company or a profit of a company to the creditors of the ruined property or as an individual’s share of it. Whereas in commercial sense, dividend has two meanings: one in relation to companies as going concerns as a portion of profits earned and allocated as payable to the shareholders yearly or whenever declared, and the other arising in winding up as that part of the residuary balance left after settling all creditors in full to be divided as between the contributories according to their respective rights from out of the value of the assets realized. The term dividend is used in this chapter in the former sense i.e. portion of profits allocated to the holders of shares.

1.2 Declaration of dividend (Section 123 of the Companies Act, 2013)

Section 123 of the Companies Act, 2013 came into force from 1st April, 2014 which provides for declaration of dividend. 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; 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.
(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.

**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.[Inserted vide Notification dated 5th June, 2015]**

(iv) Such 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**: According to the Companies (Amendment) Act, 2015, no company shall declare dividend unless carried over the previous losses and depreciation not provided in previous years 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:

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

(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,

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\text{Total amount that can be drawn from accumulated profits} \leq \frac{1}{10}\text{ of (Paid up share capital + Free reserves)}
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(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.
[Note: “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, inserted by the Companies (Declaration and Payment of Dividend) Amendment Rules, 2014” has been deleted vide Notification no. GSR 441(E) dated 29th May 2015.]

(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 five 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.

[Inserted vide Notification dated 5th June, 2015]

(vii) 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) 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.

Vide Notification no. 465(E) dated 5th June 2015, 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.

(viii) 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.

Interim Dividend:
According to section 2(35), “dividend” includes any 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.

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

1.3 Right of dividend, rights shares and bonus shares to be held in abeyance pending registration of transfer of shares (Section 126 of the Companies Act, 2013)

Section 126 of the Companies Act, 2013 came into force from 1st April, 2014 which provides for Right of dividend, rights shares and bonus shares to be held in abeyance pending registration of transfer of shares. According to this section:

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.

1.4 Punishment for failure to distribute dividends (Section 127 of the Companies Act, 2013)

Section 127 of the Companies Act, 2013 came into force on 12th September, 2013 which provides for 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 thirty 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.

Vide Notification no. 465(E) dated 5th June 2015, this section shall apply to the Nidhis company, subject to that where the dividend payable to a member is one hundred 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 three months.
1. Unpaid or Unclaimed Dividend (Section 205A of the Companies Act, 1956)

Where a dividend has been declared by a company but has not been paid, or claimed within thirty days from the date of the declaration, to any shareholder entitled to the payment of the dividend, the company shall, within seven days from the date of expiry of the said period of thirty days, transfer the total amount of dividend which remains unpaid or unclaimed within the said period of thirty days, to a special account to be opened by the company in that behalf in any scheduled bank, to be called “Unpaid Dividend Account of Company Limited/Company (Private) Limited”.

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.

Where the default is made in transferring the unpaid or unclaimed amount of dividend to the unpaid dividend account of the company, the company shall, from the date of such default, pay interest on so much of the amount as has not been transferred to the said account, at the rate of 12% 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.

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 seven years from the date of such transfer shall be transferred by the company to the Investor Education and Protection Fund established under sub-section (1) of section 205C of the Companies Act, 1956.

If a company fails to comply with any of the requirements of this section, the company, and every officer of the company who is in default, shall be punishable with fine which may extend to Rs.5000 for every day during which the failure continues.

2. Payment of Unpaid or Unclaimed Dividend (Section 205A(5) of the Companies Act, 1956)

According to Section 205A(5) of the Companies Act, 1956, 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 seven years from the date of such transfer shall be transferred by the company to the Investor Education and Protection Fund established under sub-section (1) of section 205C of the Companies Act, 1956.

No claims shall lie against the Investor Education and Protection Fund or the company in respect of individual amounts which were unclaimed and unpaid for a period of seven years from the dates that they first became due for payment and no payment shall be made in
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3. Investor Education & Protection Fund (Section 205C of the Companies Act, 1956)

The Central Government shall establish a fund, called as Investor Education and Protection Fund. The Fund shall be utilized for promotion of investors’ awareness and protection of the interests of investors in accordance with such rules as may be prescribed.

The following amounts shall be credited to the Fund:
(a) amounts in the unpaid dividend accounts of companies;
(b) the application moneys received by companies for allotment of any securities and due for refund;
(c) matured deposits with companies;
(d) matured debentures with companies;
(e) the interest accrued on the amounts referred to in (a) to (d) as above;
(f) grants and donations given to the Fund by the Central Government, State Governments, companies or any other institutions for the purposes of the Fund; and
(g) the interest or other income received out of the investments made from the Fund:

However, the amounts referred to in clauses (a) to (d) shall not form the part of the Fund, unless such amounts have remained unclaimed and unpaid for a period of seven years from the date they became due for payment.

On the contrary no claims shall lie against the Investor Education and Protection Fund or the company in respect of individual amounts which were unclaimed and unpaid for a period of seven years from the dates that they first became due for payment and no payment shall be made in respect of any such claims.

4. Payment of Interest Out of Capital (Section 208 of the Companies Act, 1956)

Where any shares in a company are issued for the purpose of raising money to defray the expenses of the construction of any work or building, or the provision of any plant, which cannot be made profitable for a lengthy period, the company may—
(i) pay interest on so much of that share capital as is for the time being paid up, for the period and subject to certain conditions and restrictions.
(ii) charge the sum so paid by way of interest, to capital as part of the cost of construction of the work or building, or the provision of the plant.

No such payment shall be made unless it is authorised by the articles or by a special resolution.

No such payment, whether authorised by the articles or by special resolution, shall be made
without the previous sanction of the Central Government.
Before sanctioning any such payment, the Central Government may, at the expense of the company, appoint a person to inquire into, and report to the Central Government on, the circumstances of the case; and may, before making the appointment, require the company to give security for the payment of the costs of the inquiry.
The payment of interest shall be made only for such period as may be determined by the Central Government; and that period shall in no case extend beyond the close of the half-year next after the half-year during which the work or building has been actually completed or the plant provided.
The rate of interest shall, in no case, exceed four per cent per annum or such other rate as the Central Government may, by notification in the Official Gazette, direct.
The payment of the interest shall not operate as a reduction of the amount paid up on the shares in respect of which it is paid.