Company Law : Dividends An Overview

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Synopsis

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Abstract

In a company which makes profit it becomes a cardinal issue on how to use this profit for the benefit of both the partners of the company and the company which in itself is in existence due to these partners.

Understanding these concepts would give rise to clear indications on how a company should and in current market uses it's profits to the benefits of it's own partners as well as the company.This project/paper would consistently deal with the problem of division of profits mainly among the partners of the company and how decisions related to such matters are taken.

The approach taken to find answers to these questions would be analysis of company models, analysis of already recorded field data and study of comments made by various diligent authors who have contributed to the field of company law. This paper would mainly deal with company laws related to dividends in india and thereafter the development which took place over the years.

The result of this paper would try to bring about an clear understanding and procedure that is undertaken to take decisions related to dividends and factors affecting it. The results emanating from this project would be a trail from general to specific study of the topic. Considering the amount of study being undertaken to make this project the result would come out as specific in terms of details.

This project is an emphasis on the scope, legality and the legal principles pertaining to the topic and therefore would be a first hand legal handout on the topic.

Introduction to Dividends : What are Dividends ?:

Dividend is the share profit that is accredited to each individual member of a company. It is the part of company profits which are set aside and "declared by the company as liable to be distributed among the shareholders."[2] These profits which are divided among the members are termed as "dividends". It is very important that we note that no special authority is needed in the memorandum of association for enabling a company to pay dividends. It could then be said it is a natural or implied right vested with the companies.

However, the freedom this restricted by mainly two fundamental principles. The first being that the dividend can never be paid out of capital and second that it should always be paid out of profits. The companies Act provides for three sources for payment of dividend.

1. Profits of the company for the year for which dividend are to be paid;
2. Undistributed profits of the previous financial year[3]
3. Money provided by the Government for such purpose in pursuance of a guarantee by the Government concerned.

The restrictions put were in the light of dividends being paid out of capital turning out to be a breach of trust and may require the directors to replace the capital.[4]

Section 2(14A) Defines dividend as to include any "interim dividend". This definition does not help us in understanding the meaning of dividend.

It would help in understanding the term 'dividend' if exploration of the term divisible profits is done. Divisible profits are those profits which can be legally distributed are called 'divisible profits'. Thus all profits of a company cannot be said to be divisible amongst the shareholders. Dividends fall under the category of divisible profits.

As per Section 2(35) of Companies Act, 2013 defines including any interim dividend.

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[2] Ghulam Hassan J in Bacha F. Guzdar v CIT, AIR 1955 SC 74: (1995) 1 SCR,876 (India).

[3] Payment out of reserves has to be in accordance with the Companies (Declaration of Dividend out of reserve) Rules,1975.

[4] K. Madhava v Popular Bank (1969) 39 Comp Cas 717:AIR 1970 Ker 131 (India).

- Dividend is basically the share of profit distributed among shareholders.
- Ordinary meaning of dividend is a share of profits, whether at a fixed rate or otherwise, allocated to holders of shares in a company.
- Dividend can be paid on Equity or preference shares both.

The word "Dividend" has origin from the Latin word "Dividendum". It means a thing to be divided.

Process followed in sharing of dividends : What are the rules and restrictions ?

Sources of dividends are mentioned in Section 205 of Companies Act,2013(Herein after referred to as 'Act)' which provides for simply three sources

1. Current Profits
2. Past reserves created out of profits then or credit balance/extra profits incurred and showed in profits and loss account and then subsequently brought forward;
3. Out of money provided by the government

It would be pertinent to note that Section 205 the Act provides that a company must transfer a prescribed percentage of it's profits (usually not exceeding 10%) to it's reserve before giving out dividend. Rules for this have been devised by the government which point at minimum amount to be transferred to its reserve before declaring dividends.. These rates are:

Percent rate of dividend proposed	Minimum percentage of profits to be transferred to the reserve
10% to 12.5%	2.5%
12.5% to 15%	5%
15% to 20%	7.5%

It would be important to note that these rates have decided by the finance department of the government and there was no hand of judicial processes in formulating these percentages.

And such has been enumerated in the Section 205 A(3) provides that the dividend can be declared out of the reserves with the rules that were and are framed by Central Government.

Declaration of dividend

The rate of dividend is decided by the Board of Directors (Herein after referred to as BOD) of a company and is declared by the shareholders in the Annual General Meeting (Herein after referred to as AGM).

In this relation Section 173 of the Act stipulates that declaration of dividend should be shown as an ordinary business at an AGM of company. Further Section 217 provides that, Directors should mention in their report to the shareholders the amounts, if any, which they recommend should be paid by the way of dividend.

This clears the role of directors in declaration of dividend and it then could be said that declaration of dividend by the directors of the company is one of the most important step which should be completed by them in the AGM.

But such declarations should be done carefully because once a dividend is declared it cannot be revoked for the reason of declared dividends creating a debt for the shareholders. Exception being war, imposition of fresh taxes etc. after the declaration is done act as a valid excuse in the eyes of law for revoking the dividend.

Before the declaration of dividend even takes place a part of profits may be distributed before the accounts are presented and dividends are declared. Such dividend are called 'interim dividend'. Section 205 of the Act allows BOD to declare such dividends.

Rules pertaining to Payment of Dividends

Section 206 of the Act acts in this perspective and provides that no dividends shall be paid by a company in respect of any share therein except

a) To the registered holder of such share or to his bankers; or
b) In case a share warrant has been issued in respect of the share in pursuance of Section 114, to bearer of such warrant or to his bankers.

Thus, if a shareholder has issued a compulsory notice for payment of dividends on his shares to a bank, the company paying the dividend to the bank accordingly, would get a good discharge for the payment so made and the dividend shall be deemed to have been paid to the shareholder in cash as contemplated under s.205.

Thus, it is clear that dividend is required to be paid only to the registered shareholders only. It would be important to note that section 205 provides that, no dividends shall be paid except in cash. However, it does not in it's limiting powers prohibit capitalisation of profits or reserves of the company for the purpose 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.

In the ruse of such discussions it would be pertinent to explore the case of Dovey v Cory[5] in which Lord Macnaghten said " I do not think it is desirable for any tribunal to do what tribunal to do what the parliament has abstained from doing i.e to formulate rules for the guidance and embarrassment of businessmen in the conduct of business affairs.

The real question for determination therefore, is whether there are profits available for distribution and this question is subjected to the facts of every case, the nature of the company and the competent witness. All this in the view of the word "profit" not having any particular narrow definition.[6]

Thus dividend have been treated as a fluid concept. The primary concern of the courts has been that the capital is maintained in the form of assets if not equal to the paid up capital at least sufficient to go round the creditors.[7]

The logic which was followed was that "People put their money into a trading company to give them an income and the sudden stoppage of all dividends would send down the value of their shares to zero and possibly involve it's ruin"[8]

Another rule which was devised subsequently in payment of dividends was that there would be a Separate Bank Account made for payment of dividends. In this development Three- Subsections have been added to sub- section (1-A), provides that the board of directors may declare an interim dividend. The amount of interim dividend as well the dividend has to be deposited to in separate bank account. All of this was enumerated in the sub-section (1) of the Section 205 added by the Amendment Act of 2000. The treatment of the interim dividend and the dividend

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[5] 1895-99 A11 ER Rep 724 : 1901 AC 477.

[6] Farewll J in Bond v Borrow haemaitite Steel Co. (1902) 1 Ch 353 (India).

[7] Verner v General And Commercial Investment Trust Co. (1894) 2 Ch. 353 (India).

[8] Macnaghten LC in Dovey v Cory 1901 AC 477 : (1895 – 99) All ER Rep 724.

has been treated equally at par as Sub-Section (3) provides that the provisions contained in the Section 205, 205, 205-A,205-C,206,206-A and 207 shall, to the extent possible, apply as much to interim dividend as they apply to regular dividend.

Legal Regime

Section 205 of the Act regulates the declaration and distribution of dividend. All the companies which have share capital other than section 25 companies and make profit are bound by law to declare and distribute dividends. As per Section 205 of the Companies Act, 1956, a dividend (including interim dividend) can be paid out of current profits or profits accumulated of earlier years. However, depreciation for the entire year has to be provided before a dividend is declared or paid. For this purpose, the Board needs to approve the provisional financial results (unaudited) and a working of the profits available for distribution as dividend, post providing for depreciation for the full year and amount required to be transferred to reserves as per the Companies.[9] Sections 205 A, B and C deal with some other aspects of distribution of dividend such as establishment of Investor Education and Protection Fund, Payment of unpaid and unclaimed dividend etc.

Separate bank account needs to be opened and the amount of dividend will have to be transferred to that account. Dividend will have to be remitted within 30 days of declaration. The other procedure of record date/book closure, payment of tax on dividend within 7 days of declaration, etc. will have to be complied with.Dividend is also payable out of divisible profits or out of moneys provided by the Central or any State Government for the payment of dividend in pursuance of a guarantee given by that Government.

Steps involved in process of declaration of dividends

Computation of Depreciation

Depreciation shall be provided either at the rate specified in Schedule XIV or any other basis approved by the central government.

[9] (Transfer of Profits to Reserves) Rules, 1975.

Compulsory Transfer of Profits to Reserves

Before declaring the dividend, the some part of the profit has to compulsorily transferred to the Reserves of the Company. This amount is based on the proposed rate of dividend.[10] However voluntary transfer of higher percentage to reserves is permitted subject to the conditions stipulated in the Act.

Board Resolution

The most important step in the process is the Board Resolution for declaration of dividends. Unless the Board recommends the payment of dividend, the same cannot be declared at an Annual General Meeting.

Annual General Meeting ("AGM")

The item pertaining to declaration of dividend should be included in the agenda of the notice for AGM which should be sent to members as well as the creditors. An ordinary resolution is required for declaration of dividend. However shareholders cannot increase the amount of dividend recommended by the Board.

Time Limit for payment of Dividend

The dividend account should be opened with the company's bankers and the dividend amount payable should be transferred to that account. Within 30 days of the AGM the dividend warrants should be sent to the shareholders.

Transfer to unpaid dividend account

Within 7 days from the date of expiry of 30 days from the date of dividend declaration, the amount remaining unpaid or unclaimed should be transferred to the 'unpaid dividend account' to be opened in a scheduled Bank. Dividend which remains unpaid or unclaimed for a period of 7 years shall be transferred to the

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[10]The Companies (Transfer of Profits to Reserves) Rules, 1975 set out different thresholds/limits for the percentage of profits to be transferred to reserves depending upon the extent of the dividend proposed to be paid. Under the said Rules, if the proposed dividend exceeds 20% of the paid-up capital, the amount to be transferred to reserves should be at least 10% of the current profits. The Company has informed us that they have applied this threshold in arriving at the amount of INR 20 crores and have assumed, for such computation, that the profits (net of tax) for the entire year would be approximately INR 200 crores.

Investor Education and Protection Fund within a period of 30 days of its becoming due for the transfer.[11]

Special Note

Tax Limit

In addition to the income tax chargeable in respect of the total income of a company for any assessment year, any amount declared, distributed or paid by such company by way of dividends (whether interim or otherwise) and also whether paid out of current or accumulated profits is charged with additional tax at the rate of 15 %.12 The liability of payment of tax is on the principle officer of the company. The tax has to be paid within 14 days of declaration, distribution or payment of any dividend whichever is the earliest. The tax on distributed profit paid by the Company would be treated as the final payment of tax in respect of dividend.

Special Provisions relating to Listed Company

In addition to the steps mentioned above the listed companies also have to advance intimation regarding the venue of the Board Meeting to the stock exchange where the securities are listed. Within 15 minutes of the closure of the Board meeting, intimation is also to be sent to the stock exchange containing the particulars of dividend. Details regarding the general meeting for the declaration of dividend are also to be given to the Stock Exchange.

Comparison Of 2013 Companies Act With 1956 Companies Act

Section under CA 2013	Section under CA 1956	Matters dealt with
2(35)	2(14A)	Definition of Dividend
51	93	Payment of dividend in proportion to amount paid up.
91	154	Declaration of book closure/Record date and

[11]Governed by Investor Education and Protection Fund (Awareness and Protection of Investors) Rules, 2001 and section 205 C of the Act .

[12] Excluding surcharge and cess (which may vary every financial year).

		publication of notice of record date/book closur
123	205	Payment of dividend-sources, conditions, transfer of profits to reserve, etc.
123(5)	205, 205A(3)	Dividend shall be paid to registered shareholders and beneficial owners under CSDL/NSDL 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
126(6)	205	Restriction on payment of dividend on equity shares on failure to comply with Deposits
124	205A	Unpaid dividend to be transferred to special dividend account.
126	206A	Right of dividend, etc. — When to be kept in abeyance.
127	207	Payment of dividend must be made within 30 days of its declaration and penalty for failure to pay dividend within prescribed time limit.

Punishment For Failure To Distribute Dividend (Section 127)

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 and with fine which shall not be less than one thousand rupees for every day during which such default continues and the company shall be liable to pay simple interest at the rate of eighteen percent per annum during the period for which such default continues.

No offence under this section shall be deemed to have been committed :

- Where the dividend could not be paid by reason of the operation of any law;

- 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;
- Where there is a dispute regarding the right to receive the dividend;
- Where the dividend has been lawfully adjusted by the company against any sum due to it from the shareholder; or
- 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.

Conclusion

This research paper has compiled all the sources of information in a very brief manner and has listed out the procedures and development of Company Law relating to Dividends. Sections pertaining to dividends as well as procedural aspect of distributed dividends has been discussed. The aim of this paper was to in brief give out information on dividends which was simple and understandable in nature. The paper has to my knowledge has achieved that aim. Any person who is not having legal knowledge of company law can read this re-search paper and very easily gain the basic information relating to dividends.