

Payment of dividend – Sec-123 (Part-2)

Continued from Geeta Saar 32nd edition

10. Power to declare dividend

While approving the financial statements and the appropriation of the or the previous financial year, the amount of dividend payable is also determined by board of directors of a company who decide how much to be paid to the shareholders and how much to retain in the business. These amounts vary from year to year depending upon the amount of profit earned by the company.

The provision in clause (k) of sub-section (3) of section 134 states that board of directors must state in its Report, the amount, if any, which it recommends to be paid by way of dividend.

The dividend recommended by the board of directors as mentioned in the Directors' Report is declared' at the annual general meeting of the company. This constitutes an item of ordinary business to be transacted at every annual general meeting. It may be noted that the shareholders may declare dividend which is lesser than the amount recommended by the Board. However, it cannot declare dividend over and above the amount recommended by the Board. Article 80 of Table F of schedule I states that 'The company in general meeting may declare dividends, but no dividend shall exceed the amount recommended by the Board.'

However, Board of directors 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. Interim means temporary or provisional or intervening period of time. It is a dividend paid by the company during a financial year between two annual general meetings with the approval of the Board. It is a dividend which is approved by the Board based on the provisional financial statements or estimates for a period less than a full year. Such declaration of dividend may take place after completing a financial year but before declaration of dividend at annual general meeting. It is also provided in article 81 of table F that Subject to the provisions of section 123, the Board may from time to time pay to the members such interim dividends as appear to it to be justified by the profits of the company.

The declaration of interim dividend is dependent on the provisional financial statements or estimates. Therefore, before approving payment of interim dividend, the directors should satisfy themselves that the profit is available for distribution by way of dividend.

Regarding the nature of interim dividend, it was held in *J. Dalmia v Commissioner of Income-Tax, New Delhi [1964 SCR (7)579]* that 'Power to pay interim dividend is usually vested, by the articles of association, in the directors. For paying interim dividend a resolution of the company is not required: if the directors are authorised by the articles of association they may pay such amount as they think proper, having regard to their estimate of the profits made by the company. Interim dividend is therefore paid pursuant to the resolution of the directors on some day between the ordinary general meetings of the company'. However, it should be noted that as the power to pay interim dividend is explicitly given to the board of directors in sub section (3) of section 123, it does not require express provision in the Articles.

The Companies (Amendment) Bill, 2016 proposes to substitute sub-section (3) of section 123 as under: "(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 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.”

11. Rate of dividend

The dividend may be paid to the preference shareholder as per the fixed rate decided at the time of issue of the preference shares. However, as far as equity shares are concerned, the board of directors of the company is free to determine the rate of dividend subject to other provisions of the Act like profit of the company, adequacy of profit, etc.

With regard to declaration of interim dividend, it is also provided in proviso of sub-section (3) of section 123 of the Act that in case where the company has incurred losses 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 the immediately preceding three financial years.

However, in case a company has not declared any dividend in the immediately preceding three financial years, proviso to rule 3 (1) provides that the above provision regarding average rate does not apply.

12. Dividend to be deposited in separate bank account

Sub-section (4) of section 123 states that 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.

Even in case of companies who pay dividend or issue warrants within 5 days of declaration are expected to route this through separate bank account. Routing through separate bank account is mandated to ensure control on unpaid dividend and its transfer.

13. Date for determining entitlement to dividend

The company may close its registers or fix a record date for deciding the entitlement to receive dividend. Regulation 60 of SEBI (LODR) Regulations, 2015 provides for fixing of record date for payment of dividend. All shareholders on the record date irrespective of the holding period of shares shall be eligible to receive dividend. In case of unlisted companies, the company may close its register of members by complying with provision of section 91 of the Act.

14. Persons entitled to dividend

Dividend should be paid by the company only to its registered shareholders or to his order or to his Banker and not to any other person. The shareholder has the option to direct the company to pay the dividend due to him to any other person. The company may fix any record date of the determination of entitlement of shareholders for dividend.

Where the company has received intimation of death of a member, the dividend may be paid by the company to the nominee of the single holder, where shares are held by more than one person jointly and any joint holder dies, to the surviving first joint holder and where shares are held by more than one person jointly and all the joint holders die, to the nominee appointed by all the joint holders.

In case of insolvency of a member, the dividend may be paid to the assignee of the insolvent member and in case of a company or body corporate which is being wound up, to the liquidator.

In case of administration of assets of the deceased, dividend is to be paid to the account of administrator.

[Inserted by the notification dated 5th September, 2015 by investor education and protection fund authority (Accounting, Audit, Transfer and Refund) Rules, 2016]: In case of shares transfer to IEPF, dividend is to be paid to IEPF.

15. Exemption to Nidhi and Government Companies

The Nidhi Companies are exempted from complying with the provisions of sub-section (5) of section 123. In case of nidhi companies, 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 dividend. This exemption is provided in the notification no. G.S.R. 465(E) dated 05.06.2015.

Vide notification no. G.S.R. 463(E) dated 05.06.2015, an exemption has been given 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 from the provisions of second proviso to sub-section (1) and sub-section (4) of section 123. Hence, to such companies the rules for declaration of dividend out of accumulated profits are not applicable and the dividend need not be deposited in a separate bank account.

16. Waiver of right to receive dividend

Receipt of dividend is a right of shareholder and not an obligation. There is no provision under the Act to deal with the waiver of dividend. Hence, such provisions may be contained in the articles of the company. Further, such waiver can either be full or partial.

17. Revocation of dividend

Dividend once declared becomes a debt to the company and therefore cannot be revoked once declared.

18. Dividend in case of beneficial owner

As provided sub-section (9) of section 89, the obligation of the company of payment of dividend is towards the member and not towards the beneficial owner. However, the dividend may be paid to a beneficial owner where the shareholder instructs the company to do so. Since sub-section(5) of section 123 includes payment of dividend to registered shareholder or “to his order”, the company shall pay the dividend according to the instructions given.

While furthering this contention for ‘deemed dividend’ under Income Tax Act, 1961, the Supreme Court has held in the case of Rameshwar Lal Sanwermal v. Commissioner of Income-Tax, Assam [1980 SCR (2) 369] that ‘It is difficult to see how a beneficial owner of shares whose name does not appear in the register of shareholders of the company can be said to be a “shareholder”. He may be beneficially entitled to the shares but he is certainly not a “shareholder”. It is only the person whose name is entered in the register of shareholders of the company as the holder of the shares who can be said to be a shareholder qua the company, and not the person beneficially entitled to the shares. It is the former who is a “shareholder” within the matrix and scheme of the company law and not the latter.

We are, (sic) therefore, of the view that it is only where a loan is advanced by the company to a registered shareholder and the other conditions set out in section 2(6A)

(e) are satisfied that the amount of the loan would be liable to be regarded as 'deemed dividend' within the meaning of section 2(6A) (e)'. This established the position that payments advanced directly to beneficial owner will not assume the character of 'deemed dividend.'

19. Dividend to be paid in cash

Dividend can only be paid in cash and not in kind. Dividend is required to be paid by the company to the registered shareholders or other persons as mentioned above to his order or to his banker.

It is further stated that any dividend payable in cash may be paid by cheque or warrant or in any electronic mode to the shareholder entitled to the payment of the dividend.

Regulation 12 of SEBI (LODR) Regulations 2015 has mandated the listed entities to use any of the electronic mode of payment facility approved by the RBI, in the manner specified in Schedule I to the Regulations, for the payment of the dividends.

A proviso to the aforesaid regulation also provides that where it is not possible to use electronic mode of payment, 'payable-at-par' warrants or cheques may be issued and where the amount payable as dividend exceeds one thousand and five hundred rupees, the 'payable-at-par' warrants or cheques shall be sent by speed post.

Closely held companies also use the method of purchasing demand drafts on the name of the shareholder. In such a situation dividend would be treated as paid on the date of issue of demand draft by the bank by debiting dividend account of the company.

20. Liability to pay final dividend

While analyzing the nature of provisions made for payment of dividend, Supreme Court explained the whole process in the case of Vazir Sultan Tobacco Co. Ltd. Etc. v. Commissioner of Income-Tax Andhra Pradesh, Hyderabad [1982 SCR (1) 789] and held that 'It is, no doubt, true that the recommendations of the Directors for payment of any dividend does not create any kind of liability for the payment of the said amount. The liability for payment of any amount by way of dividend only arises when the share-holders accept the recommendations and a dividend is declared at the annual general meeting of the Company. It is open to the Directors to modify or withdraw the recommendation with regard to the payment of dividend before the said recommendation is accepted by the share-holders. It is also open to the share-holders not to accept the recommendation of the Directors in its entirety and to modify the same. The legal liability for the payment of any dividend only arises after the share-holders at the annual general meeting have decided to declare a dividend on the basis of the recommendations of the Directors or on the basis of any modification thereof. The liability for the payment of dividend only arises after the dividend has been declared by the share-holders at the annual general meeting and this liability does not relate back to any earlier date on the basis of the recommendations of the directors as the directors do not enjoy any power of declaring the dividend. The amount that may be set apart for payment of any dividend on the basis of the recommendations made by the Directors, cannot be considered to be an amount set apart for meeting a known or existing liability'.

21. Declaration of dividend in case of loss or inadequacy of profit

Second proviso to sub-section (1) of section 123 provides that owing to inadequacy or absence of profits in any financial year, if any company 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 not be made except in accordance with such rules as may be prescribed in this behalf. It is further

provided that no dividend shall be declared or paid by a company from its reserves other than free reserves.

The conditions for the declaration of dividend in case of inadequacy or absence of profits are prescribed in Rule 3 of the Companies (Declaration and Payment of Dividend) Rules, 2014. Rule 3 specifies that in the event of inadequacy or absence of profits in any year, a company may declare dividend out of free reserves.

The term free reserve has been defined under clause (43) of section 2 of the Act as under:

“free reserves” means such reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend:

Provided that—

- (i) any amount representing unrealised gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or
- (ii) any change in carrying amount of an asset or of a liability recognized in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value, shall not be treated as free reserves.

(To be continued...)

Contents of Geeta Saar, as extracted from ICSI Premier on Company Law, is as per notified law as on 30th September, 2016.