

Payment of dividend – Sec-123 (Part-3)

Continued from Geeta Saar 59th edition

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.

As per Rule 3, the conditions for declaration of dividend in the event of inadequacy or absence of profits in any year are as follows:

- (1) The rate of dividend declared shall not exceed the average of the rates at which dividend was declared by it in the three years immediately preceding that year. This sub-rule shall not apply to a company, which has not declared any dividend in each of the three preceding financial year.

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.

- (2) 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.

The word accumulated profit used in this sub-rule should be read as accumulated profit and transferred to reserve.

- (3) The amount so drawn shall first be utilised to set off the losses incurred in the financial year in which dividend is proposed to be declared before any dividend in respect of equity shares is declared.
- (4) The balance of reserves after such withdrawal shall not fall below fifteen per cent of its paid up share capital as appearing in the latest audited financial statement.

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. Hence, such companies need not comply with the above conditions.

22. Dividend on preference shares

Preference shareholders have priority on payment of dividend over equity shareholders. However, in the case of interim dividend, while preference shareholders need not necessarily be paid dividend before equity shareholders. Para 3.2 of secretarial standards on dividend (SS-3) suggested that the Board should set aside some sufficient to pay dividend Act at the contractive rate, although SS-3 is not issued under Companies Act, 2013. The same stand could be followed.

Dividend on cumulative preference shares which has not been declared and paid should be paid before paying any dividend to equity shareholders.

Generally, dividend on preference shares is paid annually. However, the dividend at a fixed rate on the preference shares can be paid more than once during a year, in proportion to the period of completion of current financial period over the whole financial year, by declaring it as interim dividend, in the Board meeting by the Board of directors. A suitable resolution should be passed to the effect that the dividend will be paid to the registered preference shareholders whose names appear in the register of preference shareholders as on the date of commencement of closure of share transfer books.

23. Prohibition on payment of dividend

It is provided in the Act that any company which fails to comply with the provisions of sections 73 and 74 related to prohibition on acceptance of deposits from public and repayment of deposits, etc., accepted before commencement of this Act respectively shall not, so long as such failure continues, declare any dividend on its equity shares. However, similar restrictions are not provided for default in compliance with the provisions of section 76.

24. Prohibition on company to buy-back its own share and other specified securities

Pursuant to clause (c) of sub-section (1) of section 70, in case of default in payment of dividend, a company is prohibited from making buy-back of its own shares and other specified securities. The proviso to the said clause provides that the company may buy back the shares or securities if it remedies the default and a period of three years has lapsed after such default has ceased to exist.

Sub-section (2) of section 70 provides that no company shall, directly or indirectly, purchase its own shares or other specified securities in case such company has not complied with the provisions of sections 123. This sub-section debars a company from buy back for lifetime. However, there is another school of thought according to which this bar is only till the subsistence of default and not permanent. This disqualification is wider as it includes all provisions of section 123 and not merely payment of dividend.

25. Prior intimation in case of a listed company

As per regulation 29 of SEBI (LODR) Regulations, 2015, the listed entity shall give two working (excluding the date of intimation and date of the meeting) days prior intimation to stock exchange about the meeting of the board of directors in which declaration/ recommendation of dividend is to be considered.

As per regulation 42 of SEBI (LODR) Regulations, 2015, the listed entity shall intimate the record date to all the stock exchange(s) where it is listed at least seven days in advance for the purpose of declaration of dividend.

26. Disclosure in Board's report

In accordance with clause (k) of sub-section (3) of section 134, the Board of Directors must state in its Report the amount of dividend, if any, which it recommends for declaration.

The dividend recommended by the Board of directors in the Board's Report must be declared at the annual general meeting of the company before obligation to pay is constituted. This constitutes an item of ordinary business to be transacted at every annual general meeting.

27. RBI compliances for remittance of dividend

The following documents are to be prepared and submitted to the Authorised Dealer of Foreign Exchange Department for payment of dividend to the foreign shareholders of an unlisted public limited company:

1. RCD 1 (Paragraph 10B.6 (1) - (Application for Remittance of Dividend by Indian Companies to their non-resident shareholders)

2. RCD 2 - (Statement of Non-resident shareholders to whom dividend to be remitted, details of shareholdings & and the amount of dividend to be remitted.
3. FORM A2: Application for remittance Abroad
4. Certified copies of the RBI approvals and certified copy of the Board Resolution to be submitted to the Authorised Dealer of Foreign Exchange Department.
5. List of Foreign Share Holders and amount of dividend to be remitted by T T (Telegraphic Transfer), for High value of dividend amount, and a list for obtaining the Dollar Drafts from the Authorised Dealer.
6. The exchange rate of \$ will be decided by the authorised dealer, and rate prevailing on day of payment will be considered by the Authorised dealer.
7. Certified copy of the company's audited Balance sheet and Profit and Loss Account Statement for the year/period to which the dividend relates.
8. Certified copy of the Resolution passed at the Annual General Meeting of the company declaring the dividend.
9. Certified copies of Reserve Bank's approvals obtained for issue/purchase/holding of the shares on which dividend is to be remitted abroad.

28. Income Tax compliances

The Form 15CB requires detailed enumeration of the taxability of the amount under the Income Tax Act, 1961 without giving any effect to the Double Taxation Avoidance Agreement (DTAA). Where DTAA provisions are sought to be applied, the details of the Tax Residency Certificate, applicable DTAA and its relevant article, as also tax liability under the DTAA are to be furnished. The nature of remittance is divided as – for royalties, FTS, interest, dividend; on account of business income; on account of short term and long-term capital gains; and any other remittance.

In case of dividend of preference shares, the Preference Shares (Regulation of Dividends) Act, 1960 may also be applicable.

(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.