

DECLARATION AND PAYMENT OF DIVIDEND

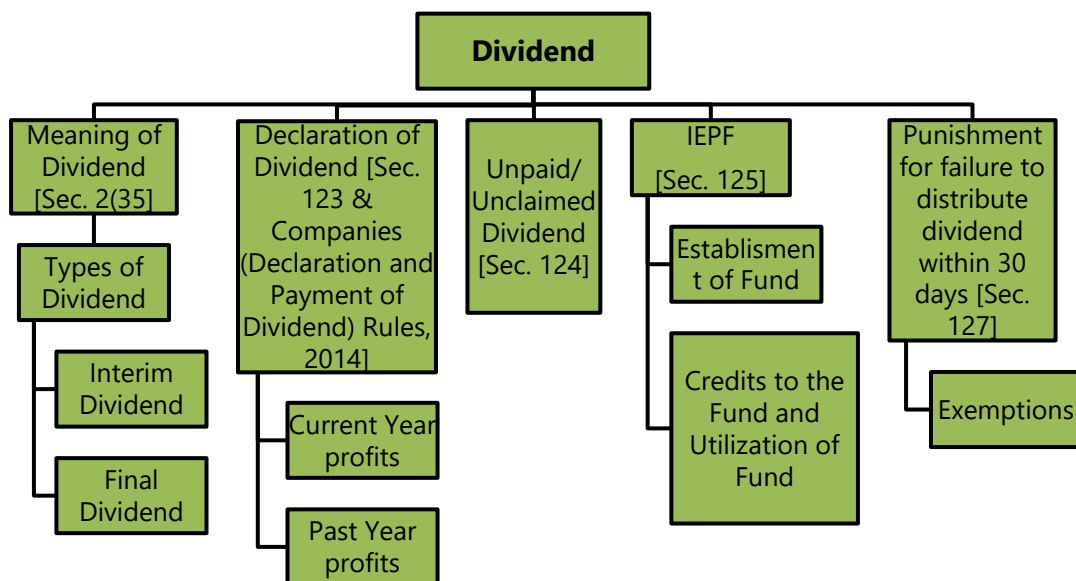


LEARNING OUTCOMES

At the end of this chapter, you will be able to:

- ❑ Understand the legal provisions relating to declaration and payment of dividend
- ❑ Learn about the conditions which need to be fulfilled before declaring dividend out of accumulated reserves.
- ❑ Appreciate the manner in which unpaid and unclaimed dividend is to be dealt with.
- ❑ Understand the nature and framework of the Investor Education and Protection Fund (IEPF).
- ❑ Appreciate the consequences for failure to distribute dividend.

CHAPTER OVERVIEW



1. MEANING OF DIVIDEND

Definition

Section 2(35) of the Companies Act, 2013, while defining the term dividend simply states that "dividend" includes any interim dividend.

This definition, instead of explaining the term merely enlarges its scope by including 'interim dividend' in its fold.

Dividend is the shareholders return on their investment / capital in the company. Dividend is part of the distributable profits which has been paid out to them. In simple words, it is a distribution of profits *i.e.* a portion of profits earned and allocated as payable to the shareholders whenever declared.



The company in general meeting may declare dividends, but no dividend shall exceed the amount recommended by the Board. (Clause 80 of Table F in Schedule I)

Dividend is recommended by Board of Directors in the Board's Report¹ and approved by Shareholders at the Annual General Meeting. Dividend is not a liability unless it is declared by the shareholders at a validly constituted general meeting by passing an ordinary resolution² at the rates recommended by the Board or such lower rates as they may decide.

Declaration of dividend by the company at a rate higher than the rate recommended by the Board is not permitted.

Dividend is Declared as a proportion of Nominal or Face Value of a share.

Example 1: AB Ltd. has issued equity shares having face value of ₹ 10 per share. The shares are currently quoting on the NSE at ₹ 250/- per share. The Company at its AGM held on 27.7.20 has declared a dividend of 20%. Mr. Shekar owns 1000 shares which he purchased at ₹ 300/- per share. What is the amount of dividend he will receive?

The dividend is to be calculated on Face Value i.e. ₹ 10/-. So dividend per share is 20% of ₹ 10/- = ₹ 2/- per share. So Mr. Shekar will receive ₹ 2 * 1000 shares = ₹ 2000/-.

Example 2: The shareholders at an annual general meeting unanimously passed a resolution for payment of dividend at a rate higher than that recommended by the directors. Discuss the validity of the resolution.

Articles of Association companies usually contain provisions with regard to declaration of dividend on the pattern of regulations 80 to 85 of Table F to Schedule I of the Companies Act, 2013. Under regulation 80, the power to declare a dividend vests with the general meeting, But not even all the shareholders have the power to declare a dividend exceeding the amount recommended by the Board of Directors.

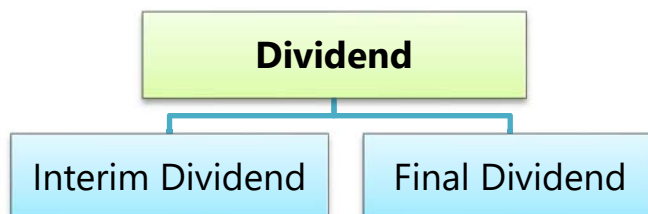
¹ As per Section 134 (3) (k).

² As per section 102 (2) declaration of any dividend at the AGM is an ordinary business requiring ordinary resolution. At any other general meeting it will be special business.



2. TYPES OF DIVIDEND

I. Classification based on time i.e. when declared



Interim Dividend

Section 123 (3) and also section 123 (4) contain provisions regarding interim dividend. Following points are noteworthy:

- ◆ Interim dividend may be declared by the Board of Directors at any time during the period from closure of financial year till holding of the annual general meeting.

The declaration of interim dividend is done out of profits before the final adoption of the accounts by the shareholders and therefore, interim dividend is said to be declared and paid between two AGMs.

- ◆ The sources for declaring interim dividend include:
 - Surplus in the profit and loss account; or
 - Profits of the financial year in which such dividend is sought to be declared; or
 - Profits generated in the financial year till the quarter preceding the date of declaration of the interim dividend.
- ◆ Declaration of interim dividend shall be ratified at the ensuing AGM by the members.
- ◆ If 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 (rate of) dividend declared by the company during the immediately preceding three financial years.

Example 3: If a company declared dividend at the rate of 16% during the immediately preceding three financial years, then in case the company

incurs loss in the current financial year, it is permitted to declare interim dividend at a rate which is not higher than 16%.

- ◆ The amount of the dividend, including interim dividend, shall be deposited in a separate account maintained with a scheduled bank within five days from the date of declaration.
- ◆ All provisions which are applicable to the payment of dividend shall also apply in case of interim dividend.

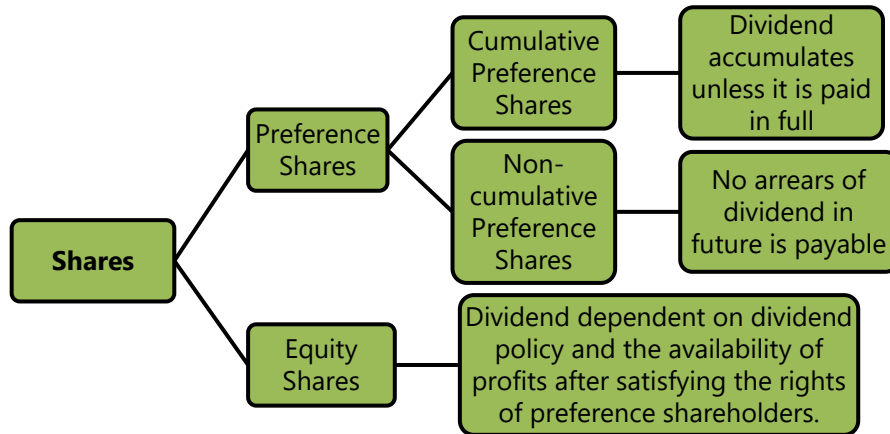
Final Dividend

- ◆ When the dividend is declared at the Annual General Meeting of the company, it is known as 'final dividend'.
- ◆ The rate of dividend recommended by the Board cannot be increased by the members.

The table given below provides a quick summary of the above concepts of Interim Dividend and Final Dividend.

BASIS FOR COMPARISON	INTERIM DIVIDEND	FINAL DIVIDEND
Definition	Interim dividend is declared and paid during an accounting year, i.e. before the finalization of accounts for the year.	Final dividend is the dividend recommended by the board of directors, and approved by shareholders at the company's Annual General Meeting, after the close of financial year.
Announcement	Announced by Board of Directors.	Recommended by Board of Directors and approved by shareholders.
Time of Declaration	Before preparation of financial statements.	After preparation of financial statements.
Revocation	It can be revoked with the consent of all shareholders.	It cannot be revoked.
Provision in Articles of Association	It is declared only when the articles specifically permits the declaration.	It does not require any specific provision in the articles.

II. Classification based on Nature of Shares does not require any specific provision in the articles.



Shares can be classified into two categories *i.e.* 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, shareholders holding preference shares are assured of a preferential dividend at a fixed rate during the life of the company.

Preference dividend unless otherwise agreed is Non-cumulative in nature and need not be paid in any year where there is deficiency of profits.

Classification of preference shares on the basis of payment of dividend is as follows:

- (a) **Cumulative Preference Shares:** A cumulative preference share is one in respect of which dividend gets accumulated and any arrears of such dividend arising due to insufficiency of profits during the current year is payable from the profits earned in the later years. Until and unless dividend on cumulative preference shares is paid in full, including arrears, if any, no dividend is payable on equity shares.
- (b) **Non-cumulative Preference Shares:** A non-cumulative preference share is one where the dividend is payable only in a year of profit. There is no accumulation of profit as in the case of cumulative preference shares. In case no dividend is declared in a year due to any reason, the right to receive such dividend for that year expires and the holder of such a share is not entitled to be paid arrears of dividend out of future year's .

- (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. PROVISIONS REGARDING DECLARATION AND PAYMENT OF DIVIDEND

A. Sources for Declaration of Dividend

According to Section 123 (1), the dividend for any financial year shall be declared or paid from the following sources:

- (a) **Profits of the current financial year-** Profits arrived at after providing for depreciation in accordance with Schedule II³.
- (b) **Profits of any previous financial year or years-** Profits of any previous financial year(s) arrived at after providing for depreciation in accordance with Schedule II and remaining undistributed *i.e.* credit balance in profit and loss account and free reserves. It is to be noted that only free reserves⁴ and no other reserves are to be used for declaration or payment of dividend⁵.
- (c) Both (a) and (b).
- (d) **Provision of money by the Government-** 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.

³ As per Section 123 (2).

⁴ Section 2 (43) defines the term 'free reserves' to mean such reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend. However, following items shall not be treated as free reserves:

- (a) any amount representing unrealised gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise; or
- (b) any change in carrying amount of an asset or of a liability recognised in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value.

⁵ As per Third Proviso to Section 123 (1).

Note 1: Before declaration of any dividend, carried over previous losses and depreciation not provided in previous year or years are required to be set off against profit of the company for the current year⁶.

Note 2: 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 excluded⁷.

Note 3: Capital profits are not same as distributable profits because they are not earned in the normal course of business; and therefore, normally not available for distribution as dividend.

Need for providing for depreciation out of profits before declaring dividend

Dividend is an apportionment from revenue profits. Therefore dividend should never be declared out of capital. This is also the reason for prohibition on issue of shares at a discount which you studied in the topic Share Capital and Debentures.

"Depreciation" is a notional estimate of the reduction in the value of an asset due to

- i. wear and tear,
- ii. efflux of time,
- iii. improvements in technology etc.

If depreciation is not provided for there will be two consequences:

- i. The value of the asset will be overstated in Balance Sheet
- ii. The profits of the current year will be overstated.

Let us take an hypothetical case where a company declares all the profits earned during any year as dividend.

At the time of winding up of the company the value of assets appearing in the Balance-sheet would appear to be sufficient to repay the capital of the shareholders but the actual realizable value thereof will be a paltry sum which may not be sufficient even to meet the expenses of winding up.

⁶ As per Fourth Proviso to Section 123 (1).

⁷ As per Proviso to Section 123 (1) (a).

This is because the company has failed to retain the amount of wear and tear in the value of the asset by way of provision for depreciation. In a way the company would have declared dividend out of capital, which is prohibited.

Hence the law mandates provision for depreciation out of profits before declaration of dividend.

Example 4: Shreyas Mechanics Limited owns a plot of land which was purchased long before. As the property rates are going up, it is decided to revalue the plot at fair value which is moderately ten times the original price, thus resulting in a revaluation profit of ₹ 20,00,000. The Board of Directors is keen to utilize this ₹ 20,00,000 along with free reserves of ₹ 24,00,000 for declaration of dividend at the forthcoming Annual General Meeting (AGM) to be held on 28th September, 2019. But according to Proviso to Section 123 (1) (a), the amount of ₹ 20,00,000 cannot be considered as it does not form part of Free Reserves as the same cannot be utilized towards declaration of dividend.

B. Transfer to Reserves

Transfer of profits to reserves for any financial year has been left to the discretion of the company. Therefore, a company is free to transfer any portion of its profit to reserves as it may deem fit. It may also decide not to transfer any amount to reserves.

Example 5: For the current year, Alma Watches Limited proposes to transfer more than 10% of its profits to the reserves before declaration of dividend at the rate of 12%. Can the company do so?

Answer: The amount to be transferred to reserves out of profits for any financial year before the declaration of dividend has been left to the discretion of the company. Therefore, Alma Watches Limited is free to transfer any part of its profits to reserves as it may deem fit.

Example 6: Brix Shipyards Limited has earned a profit of ₹ 1,000 crores for the financial year 2018-19. It has proposed a dividend @ 8.75%. However, it does not intend to transfer any amount to the reserves out of the profits earned. Can the company do so?

Answer: The amount to be transferred to reserves out of profits for any financial year has been left to the discretion of the company. The company is free to transfer any part of its profits to reserves as it may deem fit or it may even not transfer any profits to reserve if it is deemed appropriate before the declaration

of dividend. Thus, Brix Shipyards Limited is justified in its action if it does not transfer any amount of profits to the reserves.

C. Declaration of Dividend when there is inadequacy or Absence of Profits (Second Proviso to Sec. 123)

Where in any year there are no adequate profits for declaring dividend, the company may declare dividend out of the profits of any previous year transferred by it to the free reserves only in accordance with the procedure laid down in Rule 3 of *the Companies (Declaration and Payment of Dividend) Rules, 2014*.

Free Reserves ⁸ means such reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend:

The following shall not be treated as free reserves;

Any amount representing unrealized gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or

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.

Under Rule 3 such declaration shall be subject to the following conditions:

CONDITION I

The rate of dividend declared shall not exceed the average of the rates at which dividend was declared by the company in the immediately preceding three years.

$$\text{Rate of Dividend} \leq (RD_1 + RD_2 + RD_3)/3$$

Where, RD_1 , RD_2 , RD_3 are rates at which dividend was declared by the company in the immediately preceding three years.

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

CONDITION II

The total amount to be drawn from such accumulated profits shall not exceed 10% of its paid-up share capital and free reserves as appearing in the latest audited financial statement. In other words:

⁸ Section 2 (43)

Total amount that can be drawn from accumulated profits \leq *10% of (paid up share capital + free reserves)*

The amount so drawn shall first be utilised to set off the losses incurred in the financial year in which dividend is declared and only thereafter, any dividend in respect of equity shares shall be declared.

CONDITION III

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.

Free Reserves – Amount drawn for \geq *15 % of paid up share capital payment of dividend*

It may be noted that all the above three conditions have to be satisfied.

The conditions prescribed by Rule 3 are not applicable 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 (vide Notification No. 463 (E), dated 05-06-2015).

Example 7: Capricorn Industries Limited has a paid-up capital of ₹ 200 lakhs and accumulated Reserves of ₹ 240 lakhs. Loss for the year ending 31st March 2020 is ₹ 30 Lakhs. Dividend was declared at the following rates during the three years immediately preceding.

Year 1	9%
Year 2	10%
Year 3	12%

What is the maximum rate at which the company can declare dividend for the current year.

Answer: In the given case, Capricorn Industries Limited has not made adequate profits during the current year ending on 31st March, 2020, but it still wants to declare dividend. Let us apply the conditions:

Condition I:

$$\frac{9+10+12}{3} \text{ Average rate} = 10.3\%$$

Therefore, the rate of dividend shall not exceed 10.3%.

i.e. 10.3% of Paid up Capital i.e. ₹ 200 lakhs = ₹ 20.6 lakhs

Condition II:

Paid-up capital + Free reserves	=	₹ (200+240) Lakhs
(Assuming all reserves are free)=		₹ 440 Lakhs
10% thereof	=	₹ 44 Lakhs
Less: loss for the year	=	₹ 30 Lakhs
Amount available	=	₹ 14 Lakhs

Hence the quantum of dividend is further restricted to ₹ 14 lakhs.

Condition III:

Accumulated Reserves	₹ 240 Lakhs
Proposed withdrawal declaration of dividend	₹ 14 Lakhs
Balance of Reserves	₹ 226 Lakhs

This is more than 15% of paid-up capital (i.e. 15% of ₹ 200 Lakhs) i.e. ₹ 30 lakhs.

Thus, the company can declare a dividend of ₹ 14 lakhs i.e. at a rate of 7% on its paid-up capital of ₹ 200 lakhs.

Example 8: Shipra Sugar Mills Limited has been regularly declaring dividend at the rate of 20% on its equity shares for the past 3 years. However, the company has not made adequate profits during the current year ending on 31st March, 2020, but it has got adequate free reserves which can be utilized for maintaining the rate of dividend at 20%.

Advise the company as to how it should proceed in the matter if it wants to declare dividend at the rate of 20% for the year 2019-20, as per the provisions of the Companies Act, 2013.

Answer The company can declare a dividend out of its Accumulated Free Reserves subject to satisfaction of the following conditions:

- The total amount to be drawn from free reserves shall not exceed 10% of its paid-up share capital and free reserves as per the latest audited financial statement.
- The amount so drawn shall first be utilised to set off the losses incurred in the current financial year and only thereafter, dividend at 20% shall be declared.

- After such withdrawal from free reserves, the residual reserves shall not fall below 15% of its paid-up share capital as per the latest audited financial statement.

The company is advised to get the desired dividend recommended by the Board of Directors and propose the same for the approval of the members at the ensuing Annual General Meeting as the authority to declare dividend lies with the members of the company.

D. Depositing of Amount of Dividend

In terms of section 123(4), the amount of the dividend (including interim dividend), shall be deposited in a separate account maintained with a scheduled bank. This is to be done within 5 days from the date of declaration of dividend⁹.

Example 9: The authorised and paid-up share capital of Avantika Ayurvedic Products Limited is ₹ 50.00 lacs divided into 5,00,000 equity shares of ₹ 10 each. At its Annual General Meeting (AGM) held on 24th September, 2019, the company declared a dividend of ₹ 2 per share by passing an ordinary resolution. The amount of dividend must be deposited in a scheduled bank in a separate account latest by 29th September, 2019.

E. Payment of Dividend

Section 123(5) contains provisions regarding payment of dividend. These are stated as under:

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

In case a shareholder informs the company to pay dividend to a particular banker and if the payment is so made by the company, then it shall be deemed to be made to the shareholder himself.

A purchaser of shares whose name is not entered in the Register of Members cannot claim payment of dividend to him though he might have made full payment to the seller of shares. In this regard we will, later in this chapter, see Section 126 which provides for keeping of dividend etc., in abeyance pending registration of transfer of shares, unless the registered holder has authorized the company to pay the dividend to the purchaser.

⁹ In terms of *Notification No. 463 (E), dated 05-06-2015*, this requirement 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.

Example 10: The Directors of East West Limited proposed dividend at 15% on equity shares for the financial year 2018-2019. The same was approved in the Annual general body meeting held on 24th October 2019. The Directors declared the approved dividends. Mr. Binoy was the holder of 2000 equity of shares on 31st March, 2019, but he transferred the shares to Mr. Mohan, whose name has been registered on 18th June, 2019. Who will be entitled to the above dividend ?

Answer: Dividend shall be payable only to the registered shareholder or to his order or banker. In this case Mr. Binoy is the registered shareholder and therefore it shall be sufficient compliance with the law if the company pays the dividend to Mr. Binoy.

Example 11: The Board of Directors of Som Mechanical Toys Limited proposed a dividend at 12% on equity shares for the financial year 2019-20. The same was approved at the Annual General Meeting of the company held on 25th June, 2020.

Mr. Nitin Jha was holding 1,000 equity shares as on 31st March, 2020, but the same were transferred by him to Mr. Raj, whose name was registered on 20th April, 2020 in the Register of Members. State as to who will be entitled to the dividend declared by the company.

Answer: According to section 123(5), dividend shall be payable only to the registered shareholder of the shares or to his order or to his banker. Facts in the given case state that Mr. Nitin Jha, the holder of equity shares transferred his shares to Mr. Raj whose name was registered on 20th April, 2020. Since, Mr. Raj became the registered shareholder before the declaration of the dividend in the Annual General Meeting of the company held on 25th June, 2020, he will be entitled to the dividend.

Note: In terms of Section 51, a company may, if so authorised by its articles, pay dividend in proportion to the amount paid-up on each share. Suppose, some of the shareholders have paid only ₹ 5 (face value ₹ 10) on each share held by them. In case of declaration of dividend at the rate of ₹ 5 per share, the company, if authorised by its articles, shall be justified in paying dividend of ₹ 2.50 per share in respect of such partly paid shares.

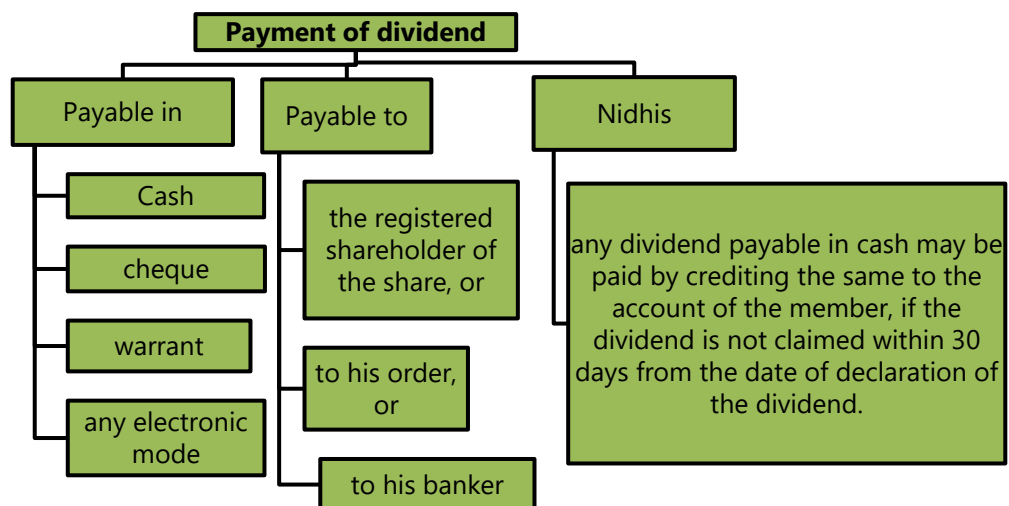
- (b) **Dividends are payable in cash and not in kind. Dividends that are payable to the shareholders in cash may also be paid by cheque or dividend warrant or through any electronic mode.**

Section 127 requires that the declared dividend must be paid to the entitled shareholders within the prescribed time limit of thirty days from the date of declaration of dividend. In case dividend is paid by issuing dividend warrants, such warrants must be posted at the registered addresses within the prescribed time. Once posted, it is immaterial whether the same are received within thirty days by the shareholders or not.

Note: Dividends shall be paid only in cash. The exception to this is 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 company¹⁰.

But you may note that while Declaration of dividend does not affect the company's power to issue fully paid up bonus shares, such shares cannot be issued in lieu of dividend.

- (c) **Applicability of Section 123 (5) to Nidhis:** In terms of Notification No. GSR 465 (E), dated 05-06-2015, this sub-section shall apply to the Nidhis, subject to the modification 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.



F. Prohibition on Declaration of Dividend

In the following cases declaration and payment of dividend is prohibited.

¹⁰ First Proviso to Section 123 (5)

(i) **Prohibition in case of any Defaulting Company:**¹¹ 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 of 2013) shall not, so long as such failure continues, declare any dividend on its equity shares.

(ii) **Prohibition in case of Section 8 Companies:**

According to section 8 (1), a company having licence under Section 8 (*Formation of companies with charitable objects, etc.*) is prohibited from paying any dividend to its members. Its profits are intended to be applied only in promoting the objects for which it is formed.

No dividend



4. UNPAID DIVIDEND ACCOUNT (UDA)

Section 124 of the Act contains the provisions relating to Unpaid Dividend Account (UDA). These are as follows:

(i) **Unpaid or Unclaimed Dividend to be transferred to the Unpaid Dividend Account-** Where a dividend has been declared by a company but has not been paid or claimed within thirty (30) days from the date of declaration, the company shall, within seven (7) days from the expiry of the said period of 30 days, transfer the total amount of unpaid or unclaimed dividend to a special account called the Unpaid Dividend Account (UDA). The UDA shall be opened by the company in any scheduled bank.

(ii) **Preparing of Statement of the Unpaid Dividend-** Within 90 days of transferring any amount to the Unpaid Dividend Account, the company shall prepare a statement containing the names, last known addresses and the amount of unpaid dividend to be paid to each person and place such statement on its web-site, if any, and also on any other web-site approved by the Central Government for this purpose.

(iii) **Payment of Interest if default is made in transferring the Amount-** If any default is made in transferring the total unpaid dividend amount or any part thereof to the Unpaid Dividend Account, the company shall pay, from the date of such default, interest at the rate of twelve per cent per annum on the amount not so transferred to the said account. The interest accruing on such amount shall

¹¹ Section 123 (6)

ensure i.e. be available to the benefit of the members of the company in proportion to the amount remaining unpaid to them.

(iv) Claimant to apply for payment of Claimed Amount- Any person claiming to be entitled to any money transferred to the Unpaid Dividend Account may apply to the company concerned for payment of the money so claimed.

(v) Transfer of Unclaimed Amount to Investor Education and Protection Fund (IEPF)- Any money transferred to the Unpaid Dividend Account which remains unpaid or unclaimed for seven (7) years from the date of such transfer shall be transferred by the company along with interest accrued thereon to the Investor Education and Protection Fund.

Further, the company shall send a prescribed statement containing the details of such transfer to the IEPF Authority and in turn, the Authority shall issue a receipt to the company as evidence of such transfer.

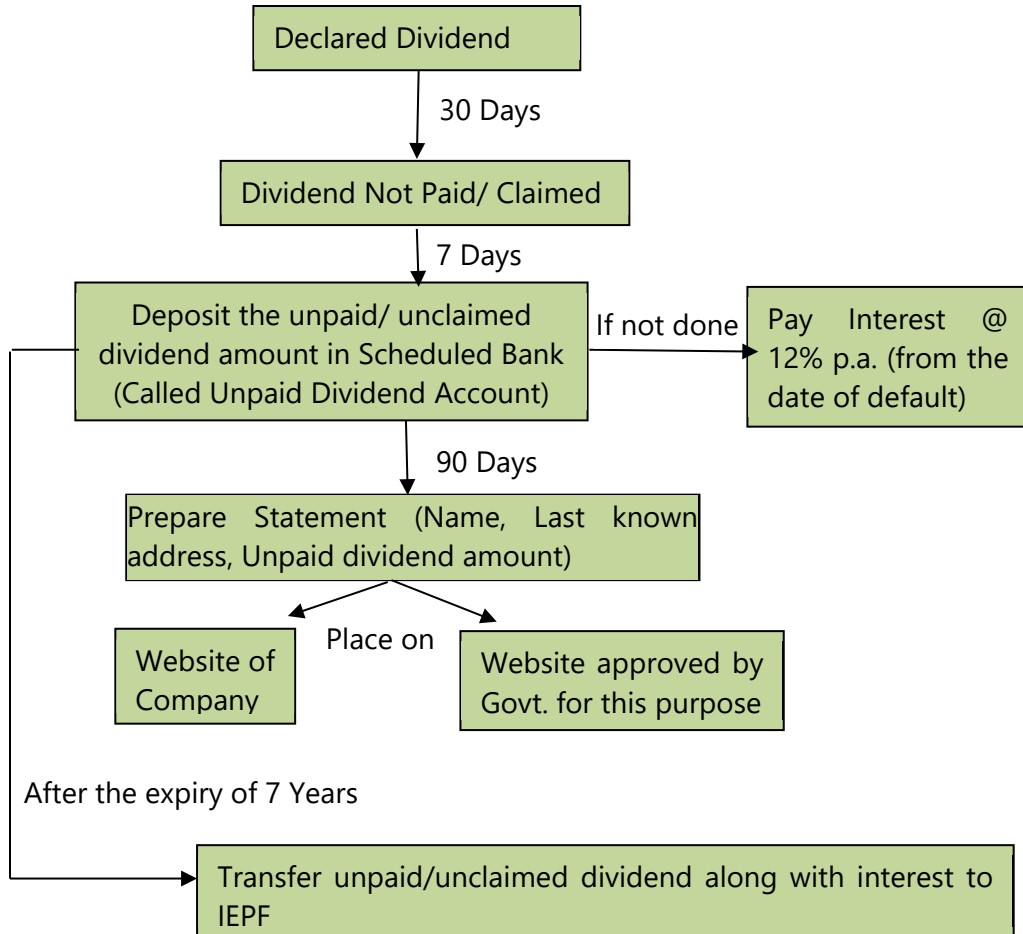
(vi) Transfer of Shares to IEPF- All shares in respect of which dividend has not been paid or claimed for 7 consecutive years or more shall be transferred by the company in the name of Investor Education and Protection Fund along with a statement containing the prescribed details.

By way of Explanation, it is clarified that in case any dividend is paid or claimed for any year during the said period of seven consecutive years, the share shall not be transferred to Investor Education and Protection Fund.

(vii) Right of Owner of 'transferred shares' to Reclaim- Any claimant of shares so transferred to IEPF shall be entitled to reclaim the 'transferred shares' from Investor Education and Protection Fund in accordance with the prescribed procedure and on submission of prescribed documents.

(viii) Punishment for Contravention- If a company fails to comply with any of the requirements relating to unpaid dividend account, it shall be punishable with minimum fine of ₹ five lakhs which may extend to ₹ twenty-five lakhs.

Further, every officer of the company who is in default shall be punishable with minimum fine of ₹ one lakh which may extend to ₹ five lakhs.



5. INVESTOR EDUCATION AND PROTECTION FUND (IEPF)

Section 125 of the Act along with various Rules framed from time to time including ¹²*Investor Education and Protection Fund Authority (Accounting, Audit, Transfer and Refund) Rules, 2016* deal with the Investor Education and Protection Fund (IEPF). This fund, being established by the Central Government, shall be credited with specified amounts and utilized for refund of unclaimed and unpaid amounts, promotion of investors' awareness and protection of the interests of investors, etc.

¹² Notified vide Notification No. GSR 854 (E), dated 05.09.2016 w.e.f. 07.09.2016.

The relevant provisions are discussed below:

1. **Credit of Specified Amounts to the Fund:** Following specified amounts shall be credited to the Fund:
 - (a) **Amount given by the Central Government-** The amount given by the Central Government by way of grants after due appropriation made by Parliament;
 - (b) **Donations by the Central Government-** Donations given by the Central Government, State Governments, companies or any other institution for the purposes of the Fund;
 - (c) **Amount lying in the Unpaid Dividend Account-** The amount lying in the Unpaid Dividend Account (UDA) of companies which is transferred by them to the Fund under section 124(5);
 - (d) **Amount in 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 the Act of 2013;
 - (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 ¹³or disposal of securities seized from a person who has been convicted for personation for acquisition of securities as provided in section 38(3);
 - (h) **Application Money-** The application money received by companies for allotment of any securities and due for refund (only if such amount has remained unclaimed and unpaid for a period of seven years from the date it became due for payment);

¹³ Disgorgement is the legally enforced repayment of ill-gotten gains imposed on wrongdoers by the courts. Funds that were received through illegal or unethical business transactions are disgorged, or paid back, often with interest and/or penalties to those affected by the action.

- (i) **Matured Deposits-** Matured deposits with companies other than banking companies (only if such amount has remained unclaimed and unpaid for a period of seven years from the date it became due for payment);
- (j) **Matured Debentures-** Matured debentures with companies (only if such amount has remained unclaimed and unpaid for a period of seven years from the date it became due for payment);
- (k) **Interest-** Interest accrued on the amounts referred to in clauses (h) to (j);
- (l) **Amount received from Sale Proceeds-** Amount received from 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 Amounts-** Such other amounts as prescribed in Rule 3 of the Investor Education and Protection Fund Authority (Accounting, Audit, Transfer and Refund) Rules, 2016. They are as under:
 - (a) all amounts payable as mentioned in clause (a) to (n) of section 125 (2) of the Act [as stated above];
 - (b) all shares in accordance with section 124 (6) i.e. all those shares in whose case dividends have not been claimed or paid for seven consecutive years or more;
 - (c) all the resultant benefits arising out of shares held by the Authority under clause (b) above;
 - (d) all grants, fees and charges received by the Authority under these rules;
 - (e) all sums received by the Authority from such other sources as may be decided upon by the Central Government;
 - (f) all income earned by the Authority in any year;
 - (g) all amounts payable as mentioned in section 10B (3) of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 and section 10B of Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980; and
 - (h) all other sums of money collected by the Authority as envisaged in the Act.

Further, according to Rule 3 (3), in case of term deposits and debentures of companies, due unpaid or unclaimed interest shall be transferred to the Fund along with the transfer of the matured amount of such term deposits and debentures.

2. Utilization of the Fund: According to section 125 (3) the Fund shall be utilized for:

- (a) refund 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 the rules framed under the Investor Education and Protection Fund Authority (Accounting, Audit, Transfer and Refund) Rules, 2016.

Refund of Amount- A person amounts referred to in clauses (a) to (d) of sub-section (2) of section 205C were transferred to IEPF, after the expiry 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.

3. Application to the Authority for payment: According to section 125 (4), 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.

4. Other Provisions governing the IEPF

- (i) **Constitution of the Authority for Administration of Fund-** In terms of Notification dated 13.01.2016¹⁴, the Ministry of Corporate Affairs

¹⁴ Vide Notification No. GSR 26 (E), dated 13.01.2016.

has notified sub-section (5), sub-section (6) (except with respect to the manner of administration of the Fund) and sub-section (7) of section 125 of the Act w.e.f. 13.01.2016. With this Notification, an Authority is being constituted for the administration and maintenance of accounts as well as other relevant records of the Fund.

Further, with the notification of *IEPF Authority (Appointment of Chairperson and Members, holding of Meetings and provision for Offices and Officers) Rules, 2016* on 13.01.2016, the Secretary, Ministry of Corporate Affairs shall be the ex-officio Chairperson of the Authority. In addition, there shall be six members (maximum limit seven) and a Chief Executive Officer who shall be the convenor of the Authority.

- (ii) **Provision of required Resources by the Central Government for Administration of the Fund-** The Central Government may provide to the Authority such offices, officers, employees and other resources in accordance with the *IEPF Authority (Appointment of Chairperson and Members, holding of Meetings and provision for Offices and Officers) Rules, 2016*.
- (iii) **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.
- (iv) **Spending of Money-** The Authority shall be competent to spend money out of the Fund for carrying out the objects specified in section 125 (3) i.e. purposes for which the fund shall be utilized.
- (v) **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. Such audited accounts together with the audit report thereon shall be forwarded annually by the Authority to the Central Government.
- (vi) **Preparation of Annual Report by the Authority-** For each financial year, the Authority shall prepare in the prescribed form and at prescribed time its annual report giving full account of its activities during the financial year and forward a copy thereof to the Central Government. In turn, 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

According to Section 126, in case any instrument of transfer of shares has been delivered by a shareholder for registration and the transfer of such shares has not been registered by the company, such company shall take the following steps:

- (a) Transfer the dividend in relation to such shares to the Unpaid Dividend Account unless it is authorised by the registered holder of such share in writing to pay such dividend to the transferee specified in the instrument of transfer; and
- (b) Keep in abeyance in relation to such shares any offer of rights shares under section 62 (1) (a) and any issue of fully paid-up bonus shares in pursuance of first proviso to section 123 (5).



7. PUNISHMENT FOR FAILURE TO DISTRIBUTE DIVIDENDS WITHIN 30 DAYS

Section 127 of the Act contains time limit for distribution of dividends and punishment for failure to distribute dividend on time. Certain exemptions from punishments are also provided. These provisions are stated as under:

A. Time Limit for Distribution of Dividends

Where a company declares dividend, it must be paid or the dividend warrant thereof must be posted within 30 days from the date of declaration of dividend to the shareholders entitled to the same. Posting of dividend warrants within 30 days absolves the company from any punishment irrespective of whether it is received by the shareholder concerned within this time or not. The offence is committed only when the company fails to post dividend warrants to the registered address of the members within 30 days of declaration. Non-receipt of dividend warrants by the shareholders within the prescribed time does not attract any punishment.

B. Punishment for Failure

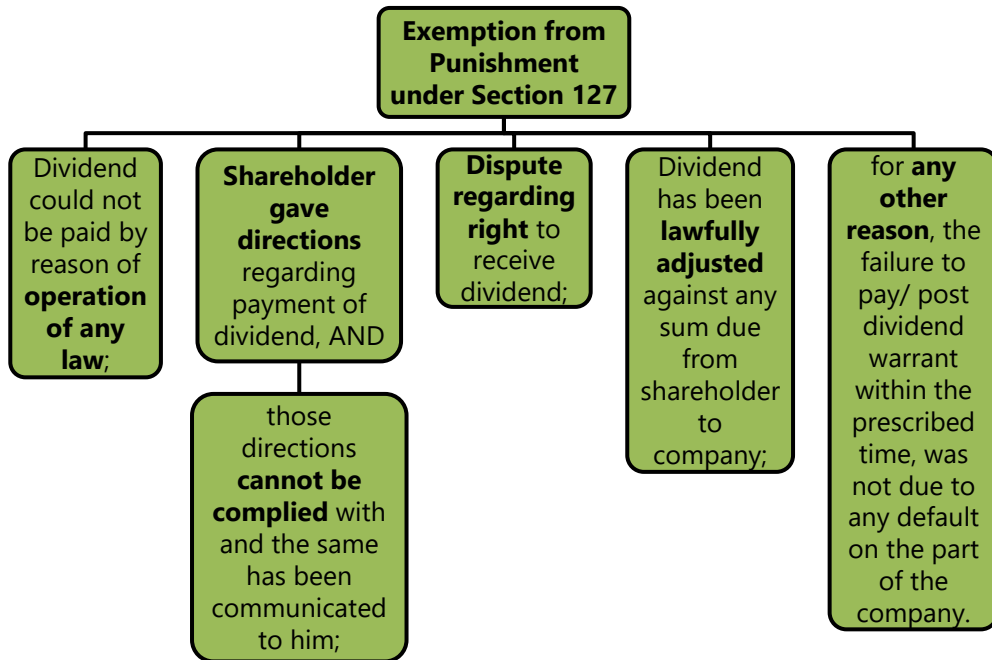
In case a company fails to pay declared dividends or fails to post dividend warrants within 30 days of declaration, following punishments are applicable:

- (i) Every director of the company shall be punishable with imprisonment of up to two years, if he is knowingly a party to the default. And, he shall also be liable to pay minimum fine of ₹ 1,000 for every day during which such default continues.
- (ii) The company shall be liable to pay simple interest at the rate of 18% p.a. during the period for which such default continues.

C. Exemption from Punishment

Under the following cases, where the company has failed to pay declared dividend within 30 days of declaration, no offence shall be deemed to have been committed and therefore, no punishment is attracted:

- (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;
- (e) where, for any other reason, the failure to pay the dividend or to post the warrant within the prescribed period of 30 days was not due to any default on the part of the company.



Example 12: Mr. Alok, holding equity shares of face value of ₹ 10 lakhs, has not paid ₹ eighty thousand towards call money due on shares. Can the dividend amount payable to him be adjusted against such dues? Give reasons for your answer.

Answer: Yes. As per clause (d) of Proviso to Section 127, where the dividend is declared by a company and there remains calls in arrears or any other sum due from a member, then the dividend can be lawfully adjusted by the company against any such dues.

Thus, the action of the company adjusting dividend payable to Mr. Alok towards call money due on shares amounting to ₹ eighty thousand is justified and therefore, no punishment is attracted.

D. Applicability of Section 127 to Nidhis

In terms of *Notification No. GSR 465 (E), dated 05-06-2015*, Section 127 dealing with punishment shall apply to the Nidhis, subject to the following modification:

In case the dividend payable to a member is ₹ 100 or less, it shall be sufficient compliance of the provisions of the section 127, 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.

SUMMARY

- ◆ Section 2(35) of the Companies Act, 2013, states that "dividend" includes any interim dividend.
- ◆ Dividend can be declared out of:
 - Profits of the current year after depreciation,
 - Profits for any previous financial year or years arrived at after providing for depreciation and remaining undistributed,
 - Both of the above,
 - 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.

[**Note:** Depreciation shall be provided in accordance with the provisions of Schedule II.]
- ◆ Before declaration of dividend, the company may, at its discretion, transfer any appropriate percentage of its profits to the reserves.
- ◆ When there is inadequacy or absence of profits, the company may declare dividend out of free reserves after following the conditions prescribed in the Rules.
- ◆ Amount of dividend (including interim dividend) shall be deposited in a separate bank account maintained with a scheduled bank within 5 days from the date of declaration of dividend.
- ◆ Payment of dividend-
 - Payable
 - ☐ in cash; or
 - ☐ by cheque; or
 - ☐ by dividend warrant; or
 - ☐ by any electronic mode
 - Payable
 - ☐ to the registered shareholder of the shares; or
 - ☐ to his order; or

- ☐ to his banker.
- In case of Nidhis
 - ☐ 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.
- ◆ Unpaid Dividend Account (UDA)
 - Declared dividend not paid or claimed to be transferred to the Unpaid Dividend Account (UDA).
 - Prepare statement of particulars of the unpaid dividend.
 - Default in transferring of amount to UDA - Interest @ 12% p.a.
 - Entitled shareholders can apply for payment of amount from UDA.
 - Transfer unpaid or unclaimed amount of dividend (and shares thereof) to Investor Education and Protection Fund (IEPF) after the expiry of seven years from the date of such transfer to UDA.
 - Right of owner of shares transferred to IEPF to claim from IEPF: Claimant of transferred shares is entitled to reclaim the transfer of shares from IEPF by following the prescribed procedure and on submission of prescribed documents.
 - In case any dividend is paid or claimed for any year during the said period of 7 consecutive years, the shares shall not be transferred to IEPF.
 - Punishment: In case a company fails to pay declared dividends or fails to post dividend warrants within 30 days of declaration, company to pay simple interest at the rate of 18% p.a. for the period of default and every director, if knowingly a party to the default – imprisonment maximum up to two years and minimum fine of ₹ 1,000 for every day during the continuation of default.
- ◆ Exemptions from punishment under section 127
 - dividend could not be paid by reason of operation of any law;
 - shareholder gave directions regarding payment of dividend but those directions could not be complied with and the same had been communicated to him;
 - dispute regarding right to receive dividend;
 - dividend had been lawfully adjusted against any sum due from the shareholder to the company;

- for any other reason and the failure to pay/post dividend warrant within the prescribed time was not due to any default on the part of the company.

TEST YOUR KNOWLEDGE

Question 1

The Annual General Meeting of ABC Bakers Limited held on 30th May, 2019, declared a dividend at the rate of 30% payable on its paid-up equity share capital as recommended by Board of Directors. However, the Company was unable to post the dividend warrant to Mr. Ranjan, an equity shareholder, up to 25th July, 2019. Mr. Ranjan filed a suit against the Company for the payment of dividend along with interest at the rate of 20 percent per annum for the period of default. Decide in the light of provisions of the Companies Act, 2013, whether Mr. Ranjan would succeed? Also, state the directors' liability in this regard under the Act.

Answer

Section 127 of the Companies Act, 2013 lays down the penalty for non-payment of dividend within the prescribed time period of 30 days. According to this section 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 of dividend to any shareholder entitled to the payment of dividend:

- every director of the company shall, if he is knowingly a party to the default, be punishable with imprisonment maximum up to two years and with minimum fine of rupees one thousand for every day during which such default continues; and
- the company shall be liable to pay simple interest at the rate of 18% per annum during the period for which such default continues.

Therefore, in the given case Mr. Ranjan will not succeed if he claims interest at 20% interest as the limit under section 127 is 18% per annum.

Question 2

The Board of Directors of Future Fashions Limited at its meeting recommended a dividend on its paid-up equity share capital which was later on approved by the shareholders at the Annual General Meeting. Thereafter, the directors at another meeting of the Board passed a board resolution for diverting the total dividend to

be paid to the shareholders for purchase of certain short-term investments in the name of the company. As a result, dividend was paid to shareholders after 45 days.

Examining the provisions of the Companies Act, 2013, state whether the act of directors is in violation of the provisions of the Act and if so, state the consequences that shall follow for the above violative act.

Answer

According to section 124 of the Companies Act, 2013, 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, 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 any scheduled bank to be called the Unpaid Dividend Account.

Further, according to section 127 of the Companies Act, 2013, 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 entitled shareholder, every director of the company shall, if he is knowingly a party to the default, be liable for punishment.

In the present case, the Board of Directors of Future Fashions Limited at its meeting recommended a dividend on its paid-up equity share capital which was later on approved by the shareholders at the Annual General Meeting. Thereafter, the directors at another meeting of the Board decided by passing a board resolution for diverting the total dividend to be paid to the shareholders for purchase of certain short-term investments in the name of the company. As a result, dividend was paid to shareholders after 45 days.

1. Since, declared dividend has not been paid within 30 days from the date of the declaration to any shareholder entitled to the payment of 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 any scheduled bank to be called the Unpaid Dividend Account.
2. The Board of Directors of Future Fashions Limited has violated section 127 of the Companies Act, 2013 as it failed to pay dividend to shareholders within 30 days due to its decision to divert the total dividend to be paid to shareholders for purchase of certain short-term investments in the name of the company.

Consequences: The following are the consequences for violation of the above provisions:

- (a) Every director of the company shall, if he is knowingly a party to the default, be punishable with maximum imprisonment of two years and shall also be liable for a minimum fine rupees one thousand for every day during which such default continues.
- (b) 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.

Question 3

Referring to the provisions of the Companies Act, 2013, examine the validity of the following:

The Board of Directors of ABC Tractors Limited proposes to declare dividend at the rate of 20% to the equity shareholders, despite the fact that the company has defaulted in repayment of public deposits accepted before the commencement of this Act.

Answer

Section 123(6) of the Companies Act, 2013, specifically provides that a company which fails to comply with the provisions of section 73 (Prohibition of 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.

In the given instance, the Board of Directors of ABC Tractors Limited proposes to declare dividend at the rate of 20% to the equity shareholders, in spite of the fact that the company has defaulted in repayment of public deposits accepted before the commencement of the Companies Act, 2013. Hence, according to the above provision, declaration of dividend by the ABC Tractors Limited is not valid.

Question 4

Star Computers Limited declared and paid dividend in time to all its equity holders for the financial year 2018-19, except in the following two cases:

- (i) *Mrs. Sheela Bhatt, holding 250 shares had mandated the company to directly deposit the dividend amount in her bank account. The company, accordingly remitted the dividend but the bank returned the payment on the ground that there was difference in surname of the payee in the bank records. The company, however, did not inform Mrs. Sheela Bhatt about this discrepancy.*

- (ii) *Dividend amount of ₹ 50,000 was not paid to the successor of Late Mr. Mohan, in view of the court order restraining the payment due to family dispute about succession.*

You are required to analyse these cases with reference to provisions of the Companies Act, 2013 regarding failure to distribute dividends.

Answer

- (i) Section 127 of the Companies Act, 2013 provides for punishment for failure to distribute dividend on time. One of such situations is where a shareholder has given directions to the company regarding the payment of the dividend and those directions could not be complied with but the non-compliance was not communicated to him.

In the given situation, the company has failed to communicate to the shareholder Mrs. Sheela Bhatt about non-compliance of her direction regarding payment of dividend. Hence, the penal provisions under section 127 will be applicable.

- (ii) Section 127, *inter-alia*, provides that no offence shall be deemed to have been committed where the dividend could not be paid by reason of operation of law.

In the present case, the dividend could not be paid because it was not allowed to be paid by the court until the matter was resolved about succession. Hence, there will not be any liability on the company and its directors, etc.

Question 5

Alpha Herbals, a Section 8 company is planning to declare dividend in the Annual General Meeting for the Financial Year ended 31-03-2019. Mr. Chopra is holding 800 equity shares as on date. State whether the act of the company is according to the provisions of the Companies Act, 2013.

Answer

According to Section 8(1) of the Companies Act, 2013, the companies licenced under Section 8 of the Act (Formation of companies with Charitable Objects, etc.) are prohibited from paying any dividend to their members. Their profits are intended to be applied only in promoting the objects for which they are formed.

Hence, in the instant case, the proposed act of Alpha Herbals, a company licenced under Section 8 of the Companies Act, 2013, which is planning to declare dividend, is not according to the provisions of the Companies Act, 2013.

Question 6

- (i) *YZ Medical Instruments Limited is a manufacturing company & has proposed a dividend @ 10% for the year 2018-19 out of the profits of current year. The company has earned a profit of ₹ 910 crores during 2018-19. The company does not intend to transfer any amount to the general reserves out of the profits. Is YZ Medical Instruments Limited allowed to do so? Comment.*
- (ii) *Karan, holder of 5000 equity shares of ₹ 100 each of M/s. Rachit Leather Shoes Limited did not pay final call of ₹ 10 per share. M/s. Rachit Leather Shoes Limited declared dividend of 10%. Examine with reference to relevant provisions of the Companies Act, 2013, the amount of dividend Karan should receive.*

Answer

- (i) According to section 123 of the Companies Act, 2013 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. Such transfer is not mandatory and the percentage to be transferred to reserves is at the discretion of the company.

As per the given facts, YZ Medical Instruments Limited has earned a profit of ₹ 910 crores for the financial year 2018-19. It has proposed a dividend @ 10%. However, it does not intend to transfer any amount to the reserves of the company out of the profits of current year.

As per the provisions stated above, the amount to be transferred to reserves out of profits for any financial year is at the discretion of the company acting through its Board of Directors. Therefore, at its discretion, if YZ Medical Instruments Limited decides not to transfer any profit to reserves before the declaration of dividend at 10%, it is legally allowed to do so.

- (ii) As per the proviso to section 127 of the Companies Act, 2013, no offence will be deemed to have been committed by a director for adjusting the calls in arrears remaining unpaid or any other sum due from a member against the dividend declared by the company.

Thus, as per the given facts, M/s. Rachit Leather Shoes Limited can adjust the unpaid call money of ₹ 50,000 against the declared dividend of 10%, i.e. $5,00,000 \times 10/100 = 50,000$. Hence, call money of ₹ 50,000 not paid by Karan can be adjusted fully from the entitled dividend amount of ₹ 50,000 payable to him.

Question 7

PQ Ltd. declared and paid 10% dividend to all its shareholders except Mr. Kumar, holding 500 equity shares, who instructed the company to deposit the dividend amount directly in his bank account. The company accordingly remitted the dividend, but the bank returned the payment on the ground that the account number as given by Mr. Kumar doesn't tally with the records of the bank. The company, however, did not inform Mr. Kumar about this discrepancy. Comment on this issue with reference to the provisions of the Companies Act, 2013 regarding failure to distribute dividend.

Answer

Section 127 of the Companies Act, 2013 provides for punishment for failure to distribute dividend on time. One of such situations is 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 not been communicated to the shareholder.

In the instant case, PQ Ltd. has failed to communicate to the shareholder Mr. Kumar about non-compliance of his direction regarding payment of dividend. Hence, the penal provisions under section 127 will be attracted.

Question 8

Alex limited is facing loss in business during the financial year 2018-2019. In the immediate preceding three financial years, the company had declared dividend at the rate of 7%, 11% and 12% respectively. The Board of Directors has decided to declare 12% interim dividend for the current financial year atleast to be in par with the immediate preceding year. Is the act of the Board of Directors valid ?

Answer

As per Section 123(3) of the Companies Act, 2013, 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.

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 the immediately preceding three financial years.

According to the given facts, Alex Ltd. is facing loss in business during the financial year 2018-2019. In the immediate preceding three financial years, the company declared dividend at the rate of 7%, 11% and 12% respectively. Accordingly, the rate of dividend declared shall not exceed 10%, the average of the rates $(7+11+12=30/3)$ at which dividend was declared by it during the immediately preceding three financial years.

Therefore the act of the Board of Directors as to declaration of interim dividend at the rate of 12% during the F.Y 2018-2019 is not valid.