## INTRICACIES OF DIVIDEND

## INTRODUCTION

Dividend distribution is an important aspect of corporate governance, reflecting a company's financial performance and its commitment towards rewarding shareholders. However, the declaration and payment of dividend is not merely a commercial decision; it is governed by a comprehensive statutory framework under the Companies Act, 2013 ("the Act"), which seeks to ensure that distributions are made out of legally available profits while safeguarding the interests of shareholders and other stakeholders.

Sections 123 to 127 of the Act, read with the Companies (Declaration and Payment of Dividend) Rules, 2014, prescribe the legal framework governing the sources, declaration, payment and treatment of unpaid or unclaimed dividend. For listed entities, the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("SEBI LODR Regulations") prescribe additional disclosure and governance requirements.

The discussion highlighted that dividend compliance extends beyond obtaining Board or shareholders' approval. It involves careful assessment of distributable profits, adherence to prescribed timelines, compliance with contractual obligations and effective monitoring of unpaid dividend and IEPF-related requirements.

### Conceptual Framework: Types and Sources of Dividend

Dividend may broadly be classified into **final dividend and interim dividend**. Final dividend is recommended by the Board of Directors and declared by the shareholders at the Annual General Meeting ("AGM"), whereas interim dividend is declared by the Board during the financial year or after closure of the financial year but before the AGM.

Section 123 of the Act provides that dividend may be declared or paid out of profits of the company for the relevant financial year, after providing for depreciation, or out of undistributed profits of previous financial years, after providing for depreciation in accordance with the applicable provisions. A combination of current and accumulated profits may also be considered. The Act also recognises money provided by the Central or State Government pursuant to a guarantee given by such Government for payment of dividend.

An important aspect is that the closing balance of the Profit and Loss Account cannot, by itself, be treated as the basis for determining distributable profits. Companies are required to consider depreciation, carried-forward losses, unabsorbed depreciation, taxes and other applicable adjustments before arriving at the amount legally available for distribution.

### Dividend out of Free Reserves: Statutory Restrictions

Where a company has inadequate or no profits in a financial year, it may consider declaring dividend out of accumulated profits transferred to free reserves, subject to the conditions prescribed under Rule 3 of the Companies (Declaration and Payment of Dividend) Rules, 2014. The withdrawal of free reserves is subject to specific safeguards. The rate of dividend should not exceed the average rate of dividend declared during the immediately preceding three financial years, subject to the applicable exception. Further, the amount withdrawn should not exceed one-tenth of the aggregate of paid-up share capital and free reserves as appearing in the latest audited financial statements. The amount withdrawn is required to be utilised first to set off losses incurred during the financial year in which dividend is declared. Additionally, the

balance of reserves after withdrawal should not fall below fifteen per cent of the paid-up share capital.

These restrictions demonstrate that the utilisation of free reserves is not an unrestricted mechanism for maintaining dividend payouts. Companies must carefully evaluate the statutory conditions before proposing any distribution from such reserves.

**Interim Dividend: Board Responsibility and Financial Assessment**

The declaration of interim dividend requires particular care as the responsibility for assessing the company's financial position rests directly with the Board of Directors. The Board must consider the financial results available up to the relevant period and evaluate whether the company has sufficient profits to support the proposed distribution.

The assessment should take into account depreciation, taxes, deferred tax, anticipated losses and preference dividend obligations. Further, where the company has incurred a loss during the current financial year up to the end of the quarter immediately preceding the declaration, the rate of interim dividend cannot exceed the average rate of dividend declared during the immediately preceding three financial years.

Unlike final dividend, interim dividend is declared by the Board and does not require subsequent ratification by shareholders. Accordingly, the Board must exercise due diligence and ensure that the proposed distribution is supported by reliable financial information rather than merely estimated profits or projections.

**Differential Rights and Preference Dividend**

The existence of different classes of shares may give rise to additional considerations while determining dividend entitlement. Companies may issue equity shares carrying differential rights as to dividend and voting, while preference shares may carry specified dividend rights in accordance with their terms of issue.

In such circumstances, the Articles of Association and the terms of issue of the relevant securities assume significance. The company must ensure that the rights attached to each class are appropriately considered while determining dividend entitlement. In the case of cumulative preference shares, unpaid dividend may accumulate in accordance with the terms of issue, whereas the treatment of unpaid dividend on non-cumulative preference shares is governed by the applicable terms.

The Board must also ensure that the declaration of dividend on one class of shares does not result in disregard of the dividend obligations attached to other classes.

**Declaration and Approval: Role of the Board and Shareholders**

The distinction between the powers of the Board and shareholders is fundamental to the dividend declaration process.

In the case of final dividend, the Board recommends the dividend and places the proposal before shareholders for declaration at the AGM. Shareholders may accept, reduce or reject the recommendation made by the Board; however, they cannot increase the amount recommended.

In contrast, Section 123(3) of the Act empowers the Board to declare interim dividend. Such declaration does not require subsequent approval or ratification by shareholders.

Before recommending or declaring dividend, companies should also examine the provisions of their Articles of Association, financing arrangements, loan covenants, debenture conditions and other contractual restrictions. Where prior approval or consent of lenders or other stakeholders is required, the same should be obtained before proceeding with the declaration.

**Dividend Payment: Timelines and Statutory Requirements**

Once dividend is declared, the company is required to comply with the payment mechanism prescribed under the Act. Section 123(4) requires the amount of dividend, including interim dividend, to be deposited in a separate scheduled bank account within five days from the date of declaration.

Further, the dividend must be paid or the dividend warrant dispatched within thirty days from the date of declaration. The five-day period for depositing the amount forms part of the overall statutory compliance process and does not extend the thirty-day payment timeline.

Companies must ensure that shareholder records, bank mandates, beneficial ownership details and payment instructions are accurate and updated. Any withholding of dividend must be supported by a valid legal or statutory basis and should not arise merely due to administrative delays or unresolved internal processes.

**Non-payment of Dividend and Unpaid Dividend Account**

Section 127 of the Act prescribes consequences where a declared dividend is not paid or the dividend warrant is not posted within thirty days from the date of declaration. In such circumstances, the company may be liable to pay simple interest at eighteen per cent per annum for the period of default. Directors who are knowingly parties to such default may also attract statutory consequences, subject to the exceptions provided under the Act.

Where dividend remains unpaid or unclaimed after the expiry of the thirty-day period, Section 124 requires the company to transfer the amount to a separate scheduled bank account known as the **Unpaid Dividend Account**, within seven days after the expiry of the said period.
The company is also required to prepare and place the prescribed statement containing details of unpaid dividend on its website, where applicable, within ninety days of the transfer. Failure to transfer the amount within the prescribed timeline attracts interest at twelve per cent per annum for the benefit of the members.

The unpaid dividend mechanism is intended to protect shareholders' entitlements and ensure that unclaimed amounts remain identifiable and available for legitimate claims.

**Transfer to Investor Education and Protection Fund**

Where dividend remains unpaid or unclaimed for seven consecutive years, the amount is required to be transferred to the Investor Education and Protection Fund ("IEPF") in accordance with Section 125 of the Act and the applicable IEPF Rules.

The corresponding shares are also required to be transferred to the IEPF where dividend has remained unpaid or unclaimed for seven consecutive years, subject to the exceptions prescribed under the applicable provisions. Before such transfer, the company must comply with the prescribed notice and publication requirements, including providing the stipulated advance notice to the concerned shareholders.

Shareholders whose dividend or shares have been transferred to the IEPF may claim the same by following the prescribed procedure, including filing Form IEPF-5 along with the requisite supporting documents. Companies are required to maintain appropriate records, complete the prescribed filings and coordinate with their Registrar and Transfer Agent to facilitate verification and processing of such claims.

**Role of the Company Secretary and Board in Dividend Compliance**

The Company Secretary plays a significant role in ensuring that the dividend process is compliant, transparent and properly documented. The process should begin well before the Board meeting, with verification of legally available profits, depreciation, accumulated losses, preference dividend obligations and applicable statutory restrictions.

The company should also review contractual restrictions, lender approvals, the Articles of Association, terms of issue, record-date requirements and applicable stock exchange disclosures. Following declaration, the compliance process must cover timely funding of the separate bank account, payment within the prescribed period, transfer of unpaid amounts to the Unpaid Dividend Account and eventual transfer to the IEPF.

The Board, including Independent Directors, must exercise due diligence while considering a dividend proposal. The decision should be supported by reliable financial information and a clear assessment of the company's statutory and contractual obligations.

**Conclusion**

Dividend declaration and distribution constitute an important component of corporate governance, requiring a careful balance between shareholder returns and the company's financial and legal responsibilities. Compliance does not conclude with the approval of a dividend proposal; it extends to timely payment, proper treatment of unpaid amounts and eventual transfer to the IEPF.

A structured dividend compliance framework, supported by financial diligence, effective Board oversight and proactive involvement of the Company Secretary, enables companies to discharge their statutory obligations while maintaining transparency and protecting shareholder interests.

In essence, effective dividend governance is not merely about distributing profits, but about ensuring that every stage of the process is undertaken in accordance with the law, supported by appropriate documentation and aligned with sound corporate governance practices.

To stay informed or access the webinar recording, visit the YouTube channel:
 **"Decoding Corporate Laws with Mehta & Mehta"**