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Payment of Dividend - Law and Practice: A Critical study with reference to the Companies Act 2013

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ABSTRACT

In the world of business law, dividend payment practices are a blend of legal rules, financial choices and corporate governance.

Dividends are not merely financial transactions; they represent the commitment of a company towards its shareholders and often reflect the financial health and stability of the organization.

In the India, the payment of dividends is governed primarily by the Companies Act, 2013 along with various regulations and guidelines issued by regulatory authorities such as the Securities and Exchange Board of India (SEBI). These legal provisions establish the framework within which Indian companies must navigate dividend-related decisions. Furthermore, judicial decisions and case laws have provided valuable insights and clarifications on the interpretation and application of these statutes.

Keywords: *Dividends, Shareholders, Companies Act.*

I. INTRODUCTION

The legal framework governing dividend payment in India is primarily established by the Companies Act 2013 along with other relevant laws and regulations.

Companies Act, 2013: The Companies Act, 2013 is the central legislation governing companies in India. It includes provisions related to the declaration and payment of dividends by companies to their shareholders.

Laws Governing Dividend Distribution under the Companies Act, 2013

Declaration of Dividends (Section 123)[2]:

- Section 123 of the Companies Act, 2013 provides the legal framework for the declaration and distribution of dividends by companies in India.

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[2] The Companies Act, 2013

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- The declaration of dividends is a prerogative of the board of directors.
- A formal resolution must be passed by the board to declare dividends.

Section 123(1)(a) of the Companies Act 2013 outlines that a company can only declare or pay dividends from its profits. Importantly, it specifies that unrealized gains, notional gains, revaluation of assets, and changes in the value of assets or liabilities at fair value should be excluded when calculating these profits.

This ensures that dividends are paid only from actual, realized profits and not from paper gains or changes in accounting values

Section 123(1)(b) of the Companies Act 2013 addresses how a company can declare dividends under certain conditions:

- Government Funding: Dividends can be paid using money provided by the Central or State Government if guaranteed by them.
- Reserve Transfer: The company can transfer a portion of its current-year profits to its reserves before declaring dividends.
- Use of Accumulated Profits: If there are insufficient profits in a given year, the company can propose dividends using accumulated profits from previous years, which have been transferred to free reserves, subject to prescribed rules.
- Dividends from Reserves: Dividends can only be paid from free reserves, not other reserve categories.
- Offsetting Previous Losses and Depreciation: Dividends cannot be declared unless previous losses and unaccounted depreciation from previous years are offset against the current year's profit.

It ensures that shareholders receive dividends only when the company has real profits, thus safeguarding their interests. This prevents companies from distributing dividends that they cannot afford, which could harm investors.

Section 123(3) of the Companies Act 2013 allows a company's Board of Directors to declare "interim dividends" at any time during the financial year, before the annual general meeting. These dividends can be funded from the company's profit and loss account surplus, current-year profits, or profits generated in the financial year until the quarter preceding the declaration. However, if the company has incurred a loss up to the end of the quarter just before declaring an interim dividend, the rate of the dividend cannot exceed the average dividends declared in

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the preceding three financial years.

This rule prevents excessive dividend payments during poor financial performance.

II. Interim Dividend

- The interim dividend means the dividend a company declares and pays before the annual general meeting, before the end of the financial year and before issuing its annual financial statements.
- Interim dividends are usually paid out of retained earnings (the previous year's earnings remaining after paying out dividends and expenses) which consist of the previous year's profit, as the current year's total earnings are yet to be realised. Interim dividends are usually lower than final dividends.

*In **Steel Co. of Canada Ltd. v. Ramsay**[3]., it was decided that the declaration of an interim dividend need not be only once a year. It may be done at any time the directors choose, and there may be several declarations in the course of one year.*

Section 123(4) of the Companies Act states that Dividends, including interim dividends, must be deposited in a scheduled bank within five days of declaration.

Section 123(5) states that Dividends are paid in cash to registered shareholders but can be paid in other forms for specific purposes like issuing bonus shares or paying unpaid share amounts.

Section 123(6) states that if a company fails to comply with specific financial regulations (Sections 73 and 74), it cannot declare dividends on its equity shares until compliance is met.

These sections of the Companies Act provide investors with assurance that dividend payments are handled responsibly, offer clarity on dividend disbursement methods, and ensure that companies remain financially compliant, thereby safeguarding investors' rights and investments

Section 124 addresses the treatment of unclaimed dividends and shares in a company.

- If a declared dividend remains unpaid or unclaimed by shareholders within 30 days from the date of declaration, the company is required to transfer the unpaid dividend to a special account called the Unpaid Dividend Account within seven days after the 30-day period.

[3] Steel Co. of Canada Ltd. v. Ramsay *[1932] 2 Comp*

- If the unpaid dividend in the Unpaid Dividend Account remains unclaimed for seven years, the company must transfer the amount, along with any accrued interest, to the Investor Education and Protection Fund (IEPF).
- Non-compliance with these provisions can result in penalties for the company and its officers. The company may face fines, and officers may be penalized if they do not adhere to these rules.

These provisions ensure that unclaimed dividends and shares are properly managed and safeguarded, benefiting shareholders and promoting financial transparency.

Section 125 establishes the Investor Education and Protection Fund (IEPF), outlines its funding sources and purposes, establishes an authority to administer the Fund, and outlines reporting and auditing requirements

Section 126 ensures that when a transfer of shares is pending registration, the company must handle dividends, rights shares, and bonus shares in accordance with the provisions mentioned above to ensure proper treatment of these financial assets and benefits.

III. Legal mechanisms or remedies for shareholders to enforce dividend payments

- Voting Rights: Shareholders can vote in favour of dividend distribution during general meetings.
- Class Action Suits: Shareholders can file class action suits against the company, its directors, or officers if dividend denial is unfair.
- Regulatory Complaints: Shareholders can file complaints with regulatory bodies like SEBI.
- Breach of Contract: Shareholders can pursue legal action for breach of contract if dividend terms are violated.
- Oppression and Mismanagement: Section 241 allows legal action if dividend denial is part of oppressive conduct.

IV. Potential consequences for companies failing to declare dividends

Section 127 deals with situations where a company declares a dividend, but the payment of that dividend is not made or the dividend warrant (a document authorizing the payment of the dividend) is not sent to the entitled shareholders within thirty days from the date of declaration.

- In such cases, every director of the company who is knowingly involved in this default can be subjected to legal penalties.
- The punishment for directors, if found guilty, can include imprisonment for a term that may extend up to two years and a fine, which shall not be less than one thousand rupees for each day during which the default continues.
- Additionally, the company itself shall be liable to pay simple interest at the rate of eighteen percent per annum for the period during which the default in dividend payment or warrant posting persists.

V. Protection of minority shareholders

The Companies Act 2013 contains provisions aimed at protecting minority shareholders in corporate decision-making

- Voting Rights: Minority shareholders have voting rights and can influence company decisions.
- Fair Treatment: Minority shareholders are entitled to fair treatment in corporate decisions.
- Class Action Suits: Provisions for class action suits under Sections 37 and 245 can help minority shareholders seek remedies in case of unfair practices or decisions.
  - Class action suits can be filed by a prescribed number of shareholders or depositors.
  - The National Company Law Tribunal (NCLT) has the authority to hear and decide on these suits.
  - If the NCLT finds the company's actions to be oppressive or prejudicial, it can pass orders to rectify the situation, including directing the company to pay damages or take corrective action.

In summary, these sections and provisions comprehensively outline the conditions and restrictions for dividend declaration, legal mechanisms for shareholders to enforce dividend payments, potential consequences for defaulting companies, and broader protections for minority shareholders in corporate governance.

VI. Compliance and enforcement of dividend laws in India

The effectiveness of regulatory mechanisms and enforcement of dividend laws can be evaluated through several key aspects:

Regulatory Bodies: Entities like the Ministry of Corporate Affairs (MCA), Securities and Exchange Board of India (SEBI), and Reserve Bank of India (RBI) oversee dividend-related compliance. MCA administers the Companies Act, SEBI regulates listed companies, and RBI issues guidelines for financial institutions.

Compliance and Disclosure: Companies must adhere to the Companies Act, 2013, for dividend declaration, funding source, and shareholder payments. Transparent disclosures in financial documents and reports are vital, with regulatory bodies monitoring compliance through inspections and audits.

Shareholder Protection: Regulatory mechanisms safeguard shareholders' rights, including dividend receipt. Non-compliance can result in legal actions, penalties, and potential liabilities for company officials.

Legal Recourse: Shareholders have legal options when there's suspected non-compliance or dividend-related disputes. They can approach regulators, seek redress through the National Company Law Tribunal (NCLT), or initiate legal proceedings.

Audit and Accounting Standards: Compliance with accounting standards and auditing practices ensures accurate financial reporting and dividend calculations.

Market Surveillance: SEBI monitors market activities and ensures listed companies adhere to dividend-related disclosure norms. Enforcement measures can be taken against violators**.**

Investor Education: Educating investors about their rights, including dividends, enhances awareness and compliance.

Case Laws and Precedents: Past legal cases related to dividends set precedents that guide companies and regulators in interpreting and enforcing dividend laws effectively.

VII. Conclusion and suggestions

The Companies Act 2013 of India is a fundamental piece of legislation, delivering numerous advantages and fostering a positive corporate landscape. Its provisions, conditions, and restrictions regarding dividend declaration and payment by companies are designed to promote transparency, fairness, and responsible corporate conduct.

One of the standout virtues of the Act is its commitment to safeguarding shareholder rights and interests. By setting forth clear guidelines for dividend distribution, it ensures that shareholders receive their rightful share of company profits. This fosters trust and confidence among investors, which in turn can attract more capital into the corporate sector, thereby facilitating economic growth.

Additionally, the Act's legal mechanisms for shareholders to enforce dividend payments serve as a powerful tool for protecting their financial interests. This empowers shareholders, particularly minority shareholders, to hold companies accountable when dividend obligations are not met.

The Act's emphasis on corporate compliance and adherence to dividend-related regulations further contributes to a culture of responsible governance. This, in turn, strengthens the overall corporate governance framework in India, enhancing the country's reputation as an attractive destination for investment.

In conclusion, the Companies Act 2013 plays a crucial role in shaping a corporate environment that values transparency, accountability, and the protection of shareholder interests. Its positive impact on dividend-related matters underscores its significance in promoting a healthy and thriving corporate sector in India and in protecting the interests of the shareholders.

Key recommendations are that policymakers should ensure clear and adaptable dividend regulations, companies should develop transparent dividend policies, adhering to ESG principles and shareholders should invest after due research and engage actively with the companies.

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