

# Dividend Governance in India

The decision to pay dividend and the amount of dividend is determined by the profits earned by the company, the decision to reinvest for future growth, current market conditions, and expectations of shareholders. Hence, dividend policies become a key factor that investors consider when evaluating a firm's long-term stability and investment appeal.



## CS Mayur Mazumdar, ACS

Assistant Manager - Legal & Secretarial  
Asian Institute of Nephrology and Urology  
Private Limited, Hyderabad  
[csmayurmazumdar@gmail.com](mailto:csmayurmazumdar@gmail.com)

## INTRODUCTION

**A** dividend is one of the simplest ways a company rewards the people who invest in it. When a business earns profits, it may choose to share a portion of those earnings with its shareholders in the form of a dividend. These payments can come as cash, additional shares, or occasionally other benefits. Dividends play a central role in the world of corporate finance, acting as a signal of financial strength, stability, and management's confidence in future earnings. For investors, dividends offer not only a steady income stream but also reflect the financial health and a means of evaluating the long-term value and reliability of a company.

In the broader world of finance, dividend decisions are an important part of how a company shapes its long-term strategy. Factors such as how much profit the company makes, how much it needs to reinvest for future growth, current market conditions, and what shareholders expect all influence whether dividends are paid and in what amount. Because of this, understanding how dividends work helps both investors looking to grow their wealth and companies aiming to maintain trust with their stakeholders.

As a result, dividend policies become a key factor that investors consider when evaluating a firm's long-term stability and investment appeal. Understanding how dividends work — and why companies choose to distribute them — is essential for anyone looking to navigate the world of financial markets more effectively.

## STATUTORY PROVISIONS

Under **Section 2(35) of the Companies Act, 2013**, “dividend” includes any interim dividend. Legally, it is not just a payout; it is a “debt” once declared by the shareholders.

### 1. Sources of Dividend

As per **Section 123(1) of the Companies Act, 2013**, a company can only declare dividends from:

- Current Year Profits: After providing for depreciation.
- Accumulated Profits: From previous financial years, transferred to the free reserves.
- Government Money: Provided by the Central/ State Government for dividend payment in pursuance of a guarantee.

Crucial Knowledge Point: You must exclude unrealized gains, notional gains, or revaluation of assets when calculating “profits.”

## THE “INADEQUACY OF PROFITS” RULE

If a company has no profits but still wants to pay a dividend from reserves, it must meet four strict conditions {**Rule 3 of Companies (Declaration and Payment of Dividend) Rules, 2014**}:

- Rate Cap:** The rate cannot exceed the average of the last 3 years' rates.
- Withdrawal Cap:** Total withdrawal cannot exceed 1/10<sup>th</sup> of (Paid-up Capital + Free Reserves).
- Loss Offset:** The withdrawn amount must first set off the current year's losses.
- Residual Balance:** The balance in reserves after withdrawal must not fall below 15% of the paid-up share capital as appearing in the latest audited financial statement.

## INTERIM VS. FINAL DIVIDEND: THE PROCEDURAL DIVIDE

Particulars	Interim Dividend*	Final Dividend
Authority	Board of Directors	Shareholders (on Board's recommendation)
Timing	During the year or before AGM	At the Annual General Meeting (AGM)
Revocability	Can be revoked with Board consent	Once declared, it is a debt
Source	P&L Surplus / Current Year Profits	Audited Financial Statements

*\*if in case the company has incurred loss during the current financial year up to the end of the quarter immediately preceding the date of declaration of interim dividend, such interim dividend shall not be declared at a rate higher than the average dividends declared by the company during immediately preceding three financial years.*

## THE “GOLDEN RULES” OF PAYMENT

1. **The 5-Day Rule:** The dividend amount including interim dividend must be deposited in a scheduled bank in a separate bank account within 5 days of declaration. *{Section 123(4) of the Companies Act, 2013}*
2. **The 30-Day Rule:** Dividend once declared, must be paid or warrants posted within 30 days from the date of the declaration to any shareholder entitled to the payment of the dividend. *{Section 124(1) of the Companies Act, 2013}*
3. **Unpaid Dividend Account (UDA):** If not claimed within 30 days, transfer the money within 7 days to a special account to be opened by the company in that behalf in any scheduled bank to be called the Unpaid Dividend Account. *{Section 124(1) of the Companies Act, 2013}*
4. **IEPF Transfer:** Any money remaining in the UDA for 7 years must be transferred to the Investor Education and Protection Fund (IEPF), along with the underlying shares. *{Section 124(5) of the Companies Act, 2013}*

## PROHIBITIONS WHEN A COMPANY “CANNOT PAY”: THE “DEFAULT” BAR (STRICT GOVERNANCE)

A company that fails to comply with Section 73 (Prohibition of acceptance of deposits) or Section 74 (Repayment of existing deposits) cannot declare equity dividends. *{Section 123(6) of the Companies Act, 2013}*

1. **Redemption of Debentures/Preference Shares:** If a company has not cleared its debt obligations to creditors or preference holders, it cannot reward equity shareholders.
2. **Term Loans:** Any default in repayment to a Bank or Financial Institution acts as a temporary “freeze” on dividend payouts.

## BOARD VS. SHAREHOLDERS: THE POWER STRUGGLE

A common misconception is that shareholders can decide how much dividend they want.

1. **The Recommendation Cap:** Shareholders in a General Meeting can reduce the rate of dividend recommended by the Board, but they have no power to increase it.

2. **Right to Revoke:** Once a Final Dividend is declared at an AGM, it becomes a debt and cannot be revoked. However, an Interim Dividend can be revoked by the Board before it is paid if the financial position of the Company suddenly deteriorates.

## DIVIDEND ON PARTLY PAID-UP SHARES (SECTION 51)

Dividends are not always “per share.”

A company is allowed to distribute dividends based not on the face value of shares, but based on how much money has actually been paid by shareholders on those shares — but only if the of the Company Articles of Association of the Company allow this.

Example: - If Share A is ₹10 fully paid and Share B is ₹10 (but only ₹5 paid), Share A gets double the dividend of Share B.

If the articles permit this rule, dividend will be paid **proportionately**:

- A gets dividend on ₹10 per share.
- B gets dividend on ₹5 per share.

## COMPLIANCES RELATED TO UNPAID DIVIDEND

If a shareholder has not claimed dividends for seven consecutive years, not only are the dividend amounts transferred to IEPF, but the underlying shares related to such dividends must also be transferred to the IEPF Authority.

**1. Statement of Unpaid Dividend:** Companies must prepare a detailed statement of shareholders whose dividends remain unpaid after the transfer to the Unpaid Dividend Account. This information must be uploaded on the website of the Company and on any other platform prescribed by the government. The purpose is to ensure accessibility and

allow shareholders to easily identify unpaid dividends due to them. *{Section 124(2) of the Companies Act, 2013}*

2. **Interest for Delay in Transfer:** If a company fails to transfer the unpaid dividend to the designated account within the prescribed time, it must pay interest at 12% per annum on the delayed amount. This interest is credited to the shareholders, ensuring they are compensated for the failure of the Company to comply with statutory timelines. *{Section 124(3) of the Companies Act, 2013}*
3. **Claiming Unpaid Dividend:** Shareholders have right to claim unpaid dividends from the Unpaid Dividend Account. They can apply to the company with necessary documents, and after verification, the company must release the unpaid dividend. *{Section 124(4) of the Companies Act, 2013}*
4. **Transfer of Shares Associated with Unpaid Dividend:** If a shareholder has not claimed dividends for seven consecutive years, not only are the dividend

amounts transferred to IEPF, but the underlying shares related to such dividends must also be transferred to the IEPF Authority. The shareholder, however, is not deprived of ownership permanently; they can reclaim their shares by following the prescribed IEPF claim process. *{Section 124(6) of the Companies Act, 2013}*

- Penalty:** If a company fails to comply with any of the requirements of this section 124 (related to unpaid dividend), such company shall be liable to a penalty of Rs. 1 Lakh and in case of continuing failure, with a further penalty of Rs.500/- for each day after the first during which such failure continues, subject to a maximum of Rs.10,00,000 and every officer of the company who is in default shall be liable to a penalty of Rs.25,000 and in case of continuing failure, with a further penalty of Rs.100/- day after the first during which such failure continues, subject to a maximum of Rs.2 Lakh. *{Section 124(7) of the Companies Act, 2013}*

### CLAIMING AMOUNT OR SHARES FROM THE IEPF

Shareholders (or their legal heirs) can claim money or shares that have been transferred to Investor Education and Protection Fund (IEPF). They must apply to the IEPF Authority in the prescribed form and manner (requiring an e-Form IEPF-5). After due verification, the authority refunds the amount or restores the shares to the claimant. This ensures that even after transfer to IEPF, investor rights are preserved. *{Section 124(6) of the Companies Act, 2013}*

### THE SEBI (LODR) LAYER: FOR LISTED ENTITIES

Dividend distribution by listed companies in India is governed not only by the Companies Act, 2013 but also by the regulatory framework established by the Securities and Exchange Board of India (SEBI). SEBI's Listing Obligations and Disclosure Requirements (LODR) Regulations, 2015 — along with periodic amendments — ensure transparency, accountability, and fair treatment of shareholders in matters related to dividends. These regulations prescribe standards on timing, mode of payment, disclosures, policy formulation, and corporate governance around dividend declarations.

- Dividend Distribution Policy:** The top 1000 listed companies (by market cap) must have a Dividend Distribution Policy (i.e. "DDP"). It should cover internal/external factors and circumstances where shareholders may/may not expect a dividend. *{Regulation 43A of SEBI (Listing Obligation and Disclosure Requirements) Regulation, 2015}*

SEBI also mandates that these listed companies to disclose their DDP on their websites and in their annual reports. This policy outlines:

- Internal & external financial parameters
- Circumstances where dividends may not be declared
- Retention vs. distribution considerations
- Usage of retained earnings

This requirement ensures transparency in dividend decisionmaking. Examples of such policies lay out factors like cash flows, capex needs, debt levels, and future growth plans.

### TIMELY DISCLOSURE OF DIVIDEND AND CORPORATE ACTIONS

- Prior Intimation:** The Stock Exchange must be notified at least 2 working days before the Board meeting where dividend is considered. For the purposes of calculating 2 working days, date to sending intimation and date of meeting to be excluded. *{Regulation 29 of SEBI (Listing Obligation and Disclosure Requirements) Regulation, 2015}*

For example: Board Meeting to be held on 5<sup>th</sup> February 2026, so the intimation need be sent to stock exchange by 2<sup>nd</sup> February 2026.

- Outcome of Board Meeting:** Board meeting outcomes related to dividend decisions/disclosures (including interim dividend or any change in DDP) must also be published within **30 minutes of board meeting conclusion** when dividends are approved to Stock Exchange where the shares of the company are listed. *{Regulation 30 of SEBI (Listing Obligation and Disclosure Requirements) Regulation, 2015}*
- Record Date:** Intimate the exchange at least 7 working days in advance about the record date. *{Regulation 42 of SEBI (Listing Obligation and Disclosure Requirements) Regulation, 2015}*
- Payment Timeline:** SEBI requires payment within 30 days, but practically, the electronic transfer (NECS/ NEFT) should be the primary mode.
- Mandatory Use of Electronic Mode for Dividend Payments:** Regulation 12 of SEBI (Listing Obligation and Disclosure Requirements) Regulation, 2015, requires listed entities to use **electronic payment modes approved by RBI** for paying dividends, interest, redemption or repayment amounts. Physical instruments like cheques or warrants may be issued only when electronic payment is not feasible. This ensures faster, safer, and more traceable payments to shareholders.

### TREATMENT OF DIVIDENDS IN RELATED PARTY TRANSACTIONS (RPT) PROVISIONS

SEBI has clarified that **corporate actions such as dividends are excluded from the scope of Related Party Transactions**, preventing unnecessary compliances when dividends are paid to related parties. This was discussed in the FAQs on SEBI (Listing Obligations and Disclosure Requirements) (Third Amendment) Regulations, 2024.

This exclusion ensures dividend payments remain purely shareholder-oriented actions, not considered transactions benefiting related parties

## ANNUAL REPORT DISCLOSURES UNDER REGULATION 53

Dividend-related disclosures form part of governance and financial transparency requirements under Regulation 53 of SEBI (Listing Obligation and Disclosure Requirements) Regulation, 2015. Amendments in 2025 updated timelines and clarity for submission of annual reports to exchanges.

These compliance obligations ensure investors receive detailed information regarding:

- Dividend history
- Dividend policy
- Proposed dividend recommendations
- Distribution trends impacting shareholder value

## CORPORATE GOVERNANCE NORMS SUPPORTING DIVIDEND DECISIONS

### 1. Independent Directors' Oversight

Independent directors must ensure dividend recommendations are fair and aligned with long-term company interest. Amendments in 2025 further strengthened governance norms for directors.

### 2. Audit Committee Responsibilities

Audit Committees review:

- Financial statements forming the basis for dividend declaration;
- Adequacy of profits; and
- Compliance with laws.

This ensures dividends are declared only when financially prudent.

## OPERATIONAL BEST PRACTICES AS PER SECRETARIAL STANDARD-3 (SS-3)

The Institute of Company Secretaries of India (ICSI) has issued Secretarial Standard – 3 which is about the dividend, the adherence of which is recommendatory.

1. Agenda notes should capture profit position, cash flows, accumulated reserves, past trends, and compliance checks before recommending/declaring dividend. Maintain clear **Board minutes** referencing.
2. Maintain a proper **Dividend Register** (amounts, list of eligible members, payment date/mode, returned payments, etc.) to evidence compliance and for later reconciliation.
3. SS-3 urges pre-payment tax readiness (TDS/TCS where applicable), capturing declarations and PAN details to reduce rejections and reconciliation lapses post-payment. Also document communications sent to shareholders for missing KYC/mandates.
4. Audit readiness: Preserve vouchers, bank confirmations, NEFT/RTGS proof, RTA confirmations, returned payment logs, and IEPF filings for audit and regulatory inspection.

5. SS-3 also highlight the nuances of “Record Date” vs. “Book Closure” and the per-share dividend amount in all communications; ensure alignment with LODR disclosure norms and the requirement of the Board to satisfy itself regarding the “Solvency” of the company before recommending a dividend.

## THE TAXATION PARADIGM: FROM DDT TO THE CLASSICAL SYSTEM

Historically, companies paid a Dividend Distribution Tax (DDT), and dividends were tax-free for most shareholders. Since April 1, 2020, India has reverted to the “Classical System.” (*Taxation Shift*) where dividends are taxed in the hands of shareholders (TDS implications).

### 1. Taxability in the Hands of the Shareholder

Dividends are now treated as “Income from Other Sources” and are taxed at the applicable slab rates of the shareholder. This means a high-net-worth individual (HNI) in the 30% bracket pays significantly more tax on the same dividend than a small investor.

### 2. TDS Compliance (Section 194 & 194K)

The company (deductor) must deduct tax at source before paying the shareholder (deductee):

For Resident Individuals: TDS is deducted at 10% if the total dividend paid by the company to the individual exceeds ₹10,000 in a financial year (Note: This threshold was increased from ₹5,000 in recent budget updates).

No PAN: If the shareholder fails to provide a PAN, the TDS rate jumps to 20%.

Exemption via Forms: Small investors whose total income is below the taxable limit can submit Form 15G or Form 15H to receive the dividend without TDS.

### 3. Deductions Allowed (Section 57)

This is a technical nuance often missed. A shareholder cannot claim any expense (like commission or salary to a portfolio manager) against dividend income, EXCEPT:

Interest Expense: If the shareholder borrowed money to invest in the shares, the interest paid on that loan is deductible.

The 20% Cap: The deduction for interest is strictly capped at 20% of the gross dividend income.

### 4. For Non-Resident Shareholders (NRIs & Foreign Cos.)

Base Rate: Taxed at 20% (plus applicable surcharge and cess) under Section 115A.

DTAA Benefit: Non-residents can opt to be taxed as per the Double Taxation Avoidance Agreement (DTAA) between India and their home country if the treaty rate is lower (often 5%, 10%, or 15%).

Required Documents: To claim treaty benefits, the non-resident must provide:

- Tax Residency Certificate (TRC).
- Form 10F.
- Self-declaration of Beneficial Ownership.

### 5. Inter-Corporate Dividends (Section 80M)

To prevent “cascading taxation” (taxing the same profit multiple times as it moves through a chain of companies), Section 80M allows a domestic company to claim a deduction for dividends received from another company, provided it distributes that dividend to its own shareholders within a specified timeframe.

#### Summary Table

Category	Tax Rate	TDS Rate	Key Condition
Resident Individual	Slab Rate (up to 30%+)	10%	Threshold: ₹10,000
Domestic Company	Corporate Tax Rate	10%	Section 80M relief available
Non-Resident (NRI)	20% or DTAA Rate	20% + Surcharge/Cess	TRC and Form 10F required

### PUNISHMENT FOR FAILURE TO DISTRIBUTE DIVIDENDS

Section 127 of the Companies Act, 2013 penalizes a company and its directors when a **declared dividend is not paid within 30 days** from the date of declaration.

#### Key Points

- Mandatory 30-day payment rule:** Once a dividend is declared, it **must be paid within 30 days**.
- Penalties on directors:** Any director who knowingly defaults may face:
  - **Imprisonment up to 2 years**, and
  - **Fine of at least ₹1,000 per day** until the default continues.
- Penalty on company:** The company must pay **18% simple interest** per annum on the unpaid dividend.
- Exceptions: no offence if:**
  - Payment is prevented due to **operation of law**,
  - Shareholder’s instructions cannot be complied with,
  - There is a **dispute** on entitlement,
  - Dividend is **lawfully adjusted** against dues, and
  - Delay was not due to default of the Company.

### ROC ADJUDICATION ORDERS

- ROC Bangalore in its adjudication order dated 15<sup>th</sup> December, 2025, penalized SYRATRON TECHNOLOGIES PRIVATE LIMITED, and its director for not depositing declared interim dividend in a separate account, violating the provisions of Section 123(4) of the Companies Act, 2013. The Adjudicating Authority imposed a penalty of ₹10,000 each on the company and on one of the director for default. *{Order ID: PO/ADJ/12-2025/BL/01182 dated 15<sup>th</sup> December, 2025}*
- ROC Mumbai issued an adjudication order dated 05<sup>th</sup> December 2025 in the matter of EAST BRIDGE ADVISORS PRIVATE LIMITED for violation of Section 123(3) of the Companies Act, 2013 the company

declared an interim dividend of ₹23,20,00,763 based on profits estimated prior to the auditors’ adjustment of tax provisions for the financial year 2023-24, post audit it resulted in over distribution of ₹17,85,147. The Adjudicating Authority imposed a penalty of ₹10,000 each on the company and on three of the directors for default. *{Order ID: PO/ADJ/12-2025/MB/01029 Dated: 5<sup>th</sup> December, 2025}*

### COURT PRECEDENTS

**Commissioner Of Income Tax v. Girdhardas & Company Private Ltd. (1966)** is a landmark Supreme Court of India case establishing that distributions by a liquidator from “accumulated profits” are taxable as dividends, but only if they represent profits from the six years prior to liquidation under Section 2(6-A)(c) of the Income Tax Act, 1922. The Court clarified that “current profits” (profits of the year of liquidation) distributed by a liquidator do not fall within this definition. *{read from here - case commentary summarized}*

### CONCLUSION

Dividend declaration is a balance between “rewarding shareholders” and “capital conservation.” In the modern ESG (Environmental, Social, and Governance) era, a transparent Dividend Distribution Policy is a hallmark of a well-governed company.

Dividend provisions under the Companies Act, 2013, SEBI LODR and related SEBI regulations collectively aim to protect shareholder interests by ensuring transparency, timely disclosures, and robust governance around dividend declaration and payment. The regulatory framework mandates electronic payments, comprehensive disclosures, policy transparency, and governance checks so that dividends reflect genuine financial health rather than cosmetic financial engineering. These provisions also guard against financial imprudence by restricting dividend payouts in situations of default or inadequate reserves, reinforcing the principle that shareholders can be rewarded only after ensuring the company remains solvent and compliant.

At the same time, the shift to the classical taxation regime has placed renewed importance on understanding dividend taxability, TDS obligations, and relief mechanisms like Section 80M. Together, these layers of law, compliance, governance, and taxation create a comprehensive framework that balances corporate flexibility with investor protection.

By integrating these rigorous standards, Regulatory Authorities ensures that dividend decisions are fair, responsible, and aligned with investor expectations — strengthening confidence in India’s capital markets.

### REFERENCES:

- <https://e-book.icsi.edu/>
- <https://indiankanoon.org>
- [www.ca2013.com](http://www.ca2013.com)
- [www.casemine.com](http://www.casemine.com)
- [www.mca.gov.in](http://www.mca.gov.in)
- [www.sebi.gov.in](http://www.sebi.gov.in)
- [www.taxguru.in](http://www.taxguru.in)

□