A Critical Analysis of Word "Divident" from an Accountants Perspective

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Dividend is a word that has different meaning in different fields. Dividend is used in Accounting, Auditing, Income Tax as well as GST.

Starting from the view point of accounting, importance of dividend is as follows:

1. **What is Dividend?**

   A dividend is a share of profits and retained earnings that a company pays out to its shareholders. When a company generates a profit and accumulates retained earnings, those earnings can be either reinvested in the business or paid out to shareholders as a dividend.

2. **How a Dividend works?**

   A dividend is paid on per-share basis and is **paid equally to all shareholders of the same class** (common, preferred, etc.). **The payment is paid by Board of Directors.**

3. **Steps how it works:**
   - The company generates profits and retained earnings.
   - The management decides to distribute some extra profit as dividend to shareholders instead of reinvesting in the business.
   - The Board of Directors approves the dividend plan.
   - The company announces the dividend (the value per share, the date when it will be paid, record date etc.)
   - The dividend is paid to the shareholders.

4. **Types of Dividends:**

   There are different types of dividends that a company pays to its shareholders. Some of them are described below which are most common that shareholders receive.

   - **Cash Dividend:** This is the payment of actual cash from the company directly to the shareholders and is the **most common type of payment**. The payment is made electronically, but may also be made by check or cash. Generally shareholders have strong preference for cash dividends.

   - **Stock Dividend:** Stock dividends rank next to cash dividends and are paid to the shareholders by issuing them new shares in the company. These are paid on pro-rata, based on the number of shares investor already owns. The payment of stock dividends does not affect cash and earning position of the firm nor is ownership of shareholders changed. It will lead to increase in the number of shares of the shareholders but there will be no change in their equity.

   - **Property Dividend:** A company is not limited in paying distributions to its shareholders in the form of cash or shares. A company may also payout there assets such as investment securities, physical assets and real estate, **although it is not a common practice.**

- **Bond Dividend:** In Bond Dividend, company promises to pay dividends at future date and to that effect issues bonds to shareholders in place of cash. Bond dividend increases long term liability of the company.

- **Scrip Dividend:** Scrip dividend means payment of dividend in scrip or promissory notes. Sometimes companies need to keep the cash generated by business earnings to meet business requirements. In such case company issues notes promising to pay dividend at a future date. Scrip may interest bearing or non interest bearing. **Such dividends are relatively scarce.**

- **Interim Dividends:** Interim dividends are dividend payments made before a companies' Annual General Meeting (AGM) and final financial statements. Interim Dividend usually accompanies the company's interim financial statements.

5. Dividend Dates:

A dividend that is declared must be approved by the Board of Directors. The following dates are necessary for the declaration of dividend:

- **Declaration Date:** It is the date on which Board of Directors announce their intention to pay dividend. On that day a liability is created in the books of the company that it owes money to its shareholders.

- **In-dividend Date:** The last day, which is one trading day before the ***ex-dividend date (the day on which shares bought and sold no longer come attached with the right to be paid the most recently declared dividend)***. That is, existing shareholders and anyone who buys shares on this day will receive the dividend and any shareholders who has sold his shares lose their right to the dividend. After this date the shares become ex-dividend.

- **Record Date:** Shareholders registered in the company's record as of the record date will be paid the dividend, while shareholders who are not registered as of this date will not receive the dividend.

- **Payment Date:** The day on which dividend cheques will actually mailed to the shareholders or the dividend amount is credited to their bank account.

6. Dividend Coverage:

The most popular metric to determine the dividend is the payout ratio.

$$\text{Payout Ratio} = \frac{\text{Dividends per share}}{\text{Earnings per share}} \times 100$$

A payout ratio greater than 100 means the company is paying out more dividends for the year than it had earned.

7. Dividend Frequency:

The dividend frequency describes the number of times dividend is paid during one business year. Most relevant dividend frequencies are annually, semi-annually, quarterly or monthly.

8. Dividend reinvestment:

Some companies have dividend reinvestment plans or DRIPs, not to be confused with scrip. DRIPs allow shareholders to use dividends to systematically buy small amounts of stock, usually with no commission and sometimes at slight discount.

From the view point of Auditing

After the view of accounting now let's come to the point of auditing. While conducting an audit of a company, an auditor is required to check various things whether they have been performed as per rules or not. Dividend is one such area which an auditor is required to pay attention. Things that an auditor must consider while conducting an audit of dividend are as follows:

- Auditor should examine the Memorandum and Articles of Association of the company to determine the rights of different classes of shareholders to whom dividend has been paid.
- Auditor should ensure that the dividend is paid only out of profits. The capital of the shareholders cannot be used for the payment of dividend.
- Auditor should ascertain whether the dividend has been calculated as per the provisions of Companies Act, 2013.
- Auditor should ascertain whether the rate of dividend has been properly recommended in a meeting of the Board of Directors.
- Auditor should inspect the shareholders minutes book to verify that the amount of dividend and confirm that the same does not exceed the amount recommended by the Board of Directors.
- Auditor should see that the profits apportioned for payment of dividend are after transfer to reserves an amount in accordance with the rules framed by the Central Government.
- Auditor should examine the list of shareholders as drawn from the Registrar of Shareholders and see that the total amount of dividend payable complies with the dividend account.

- If a separate bank account has been opened for payment of dividend, auditor should check the transfer of total amount of dividend payable from the dividends account.

- Auditor should verify the amount of unclaimed dividend with the dividend account, bank pass book and dividend warrants as have been returned undelivered.

- Auditor should that where the dividend has been declared, distributed or paid by a domestic company the tax on the same has been paid within 14 days of the declaration, distribution or payment of dividend whichever is earliest.

- The auditor must see that the **dividend which remains unpaid or unclaimed within 30 days of the declaration of the dividend**, such unpaid or unclaimed dividend has been transferred to a special bank account entitled **<u>"Unpaid Dividend Account" within 7 days</u>** from the expiry of 30 days as per section **<u>124(1)</u>** of the companies act, 2013. Such account shall be maintained with a scheduled bank.

  "124. *(1) Where a dividend has been declared by a company but has not been paid or claimed within thirty days from the date of the declaration to any shareholder entitled to the payment of the dividend, the company shall, within seven days from the date of expiry of the said period of thirty days, transfer the total amount of dividend which remains unpaid or unclaimed to a special account to be opened by the company in that behalf in any scheduled bank to be called the Unpaid Dividend Account."*

- If some dividend remains unpaid or unclaimed for a period of seven years from the date of transfer, such amount **<u>should be transferred to Investor Education and Protection Fund</u>** as per section **<u>124(5) & (6)</u>** of the companies act, 2013.

  > *"124.(5) Any money transferred to the Unpaid Dividend Account of a company in pursuance of this section which remains unpaid or unclaimed for a period of seven years from the date of such transfer shall be transferred by the company along with interest accrued, if any, thereon to the Fund established*

under sub-section (1) of and the company shall send a statement in the prescribed form of the details of such transfer to the authority which administers the said Fund and that authority shall issue a receipt to the company as evidence of such transfer.

124.(6) All shares in respect of which [dividend has not been paid or claimed for seven consecutive years or more shall be] transferred by the company in the name of Investor Education and Protection Fund along with a statement containing such details as may be prescribed:

Provided that any claimant of shares transferred above shall be entitled to claim the transfer of shares from Investor Education and Protection Fund in accordance with such procedure and on submission of such documents as may be prescribed."

- If a company fails to comply with any of the requirements of this section, the company shall be punishable with fine which **shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees** and every officer of the company who is in default shall be punishable with fine which **shall not be less than one lakh rupees but which may extend to five lakh rupees** as per section **<u>124(7)</u>** of the companies act, 2013.

  "124.(7) If a company fails to comply with any of the requirements of this section, the company shall be punishable with fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees."

<u>Presentation of Dividend in the Financial Statements</u>

A dividend is a distribution made to the shareholders that is proportional to the number of shares owned. A dividend is not an expense to the paying company, but rather a distribution of its retained earnings.

There are four components in Financial Statements. Following shows the impact of dividend on each component of the Financial Statements:

- **Balance Sheet:** The amount of cash and cash equivalents will reduce and retained earnings account will reduce after payment of dividend.

- **Income Statement:** The amount of dividend paid has no effect in income statement as it is not considered as an expense.

- **Cash Flow Statement:** The amount of dividend under cash flow statement can be shown as:
  - **Financing Activities:** Dividend may be shown as financing activities as they are part of obtaining financial resources.
  - **Operating Activities:** Dividend may be shown as operating activities as it is regular part of one's operations for payment of dividend to its investors.

- **Statement of changes in equity*:** The statement of changes in equity must disclose the dividend amount recognized as distributions and the related amount per share

  The addition to the distributions information in statement of changes in equity the following must be disclosed in the notes to accounts:
  - Amount of dividend proposed or declared before the financial statements were authorized for issue but were not recognized as a distribution to owners during the period and the related amount per share.

  - The amount of cumulative preference dividends not recognized.

*also known by the name of changes in stockholders' equity.

A brief narrative description of dividend issuance may also be given in the notes that accompany the financial statements, though these notes may not be included if the statements are only for internal purpose.

If the dividend is in the form of stock dividend, it will lead to changes in equity accounts but will not change the net equity balance.

From the view point of Income Tax Act, 1961

After all the above the discussion above, now let's come to the point that how dividend is treated under the Income Tax Act, 1961.

Dividend is defined u/s 2(22) of the Income Tax Act, 1961 as under:

> *"dividend" includes—*
>
> *(a) any distribution by a company of accumulated profits, whether capitalised or not, if such distribution entails the release by the company to its shareholders of all or any part of the assets of the company ;*
>
> *(b) any distribution to its shareholders by a company of debentures, debenture-stock, or deposit certificates in any form, whether with or without interest, and any distribution to its preference shareholders of shares by way of bonus, to the extent to which the company possesses accumulated profits, whether capitalised or not ;*
>
> *(c) any distribution made to the shareholders of a company on its liquidation, to the extent to which the distribution is attributable to the accumulated profits of the company immediately before its liquidation, whether capitalised or not ;*
>
> *(d) any distribution to its shareholders by a company on the reduction of its capital, to the extent to which the company possesses accumulated profits which arose after the end of the previous year ending next before the 1st day of April, 1933, whether such accumulated profits have been capitalised or not ;*
>
> *(e) any payment by a company, not being a company in which the public are substantially interested, of any sum (whether as representing a part of the assets of the company or otherwise) made after the 31st day of May, 1987, by way of advance or loan to a shareholder, being a person who is the beneficial owner of shares (not being shares entitled to a fixed rate of dividend whether with or without a right to participate in profits) holding not less than ten per cent of the voting power, or to any concern in which such shareholder is a member or a partner and in which he has a substantial interest (hereafter in this clause referred to as the said concern) or any payment by any such company on behalf, or for the individual benefit, of any such shareholder, to the extent to which the company in either case possesses accumulated profits ;*

But "dividend" does not include—

(i) a distribution made in accordance with sub-clause (c) or sub-clause (d) in respect of any share issued for full cash consideration, where the holder of the share is not entitled in the event of liquidation to participate in the surplus assets ;

(ia) a distribution made in accordance with sub-clause (c) or sub-clause (d) in so far as such distribution is attributable to the capitalised profits of the company representing bonus shares allotted to its equity shareholders after the 31st day of March, 1964, and before the 1st day of April, 1965 ;

(ii) any advance or loan made to a shareholder or the said concern by a company in the ordinary course of its business, where the lending of money is a substantial part of the business of the company ;

(iii) any dividend paid by a company which is set off by the company against the whole or any part of any sum previously paid by it and treated as a dividend within the meaning of sub-clause (e), to the extent to which it is so set off;

(iv) any payment made by a company on purchase of its own shares from a shareholder in accordance with the provisions of section 77A of the Companies Act, 1956 (1 of 1956);

(v) any distribution of 19shares pursuant to a demerger by the resulting company to the shareholders of the demerged company (whether or not there is a reduction of capital in the demerged company).

Dividend can be earned and also be paid. Following are the circumstances where dividend can be earned or paid:

1. **Dividend Income U/s 8:** An assessee may earn dividend income during the year. Such income shall be considered as dividend income and included in the total income of the assessee u/s 8 of the Income Tax Act, 1961 if:
    - Any dividend declared by a company or distributed or paid by it within the meaning of sub-clause (a) or sub-clause (b) sub-clause (c) sub-clause (d) or sub-clause (e) of clause (22) of section 2 shall be deemed to be the income of the previous year in which it is so declared, distributed or paid, as the case may be:
    - Any interim dividend shall be deemed to be the income of the previous year in which the amount of such dividend is

unconditionally made available by the company to the member who is entitled to it.

2. **<u>Deduction of TDS u/s 196</u>**: A person is **not required to deduct TDS** on payment made to the following:
   - The Government or,
   - The Reserve Bank of India or,
   - A corporation established by or under a Central Act which is, under any law for the time being in force, exempt from income tax on its income
   - Mutual fund specified under clause (23D) of section 10.

   Where such sum is payable to it by way of interest or dividend in respect of any securities or shares owned by it or in which it has full beneficial interest, or any other income accruing or arising to it.

3. **<u>Deduction of TDS u/s 194:</u>** The principal officer of an Indian Company or a company which has made prescribed arrangements for declaration of dividend or payment of dividend in India, in cash or before issuing a cheque or warrant in respect of dividend shall deduct from such amount of dividend, income tax at applicable rates in force, provided **no such deduction is required** if shareholder being an individual if such payment is made by account payee cheque **and** the amount of such dividend **does not exceed two thousand five hundred rupess.**

   Further, this section will not apply if the payment is made to the following:
   - The Life Insurance Corporation of India, in respect to shares owned by it or in which it has full beneficial interest.
   - The general Insurance Corporation of India, in respect to shares owned by it or in which it has full beneficial interest.
   - Any other insurer in respect of any shares owned by it or in which it is full beneficial interest.

No such deduction under this section shall be made in respect of dividend **under section 115-O.**

4. **Dividend U/s 115-O:** A domestic company in addition to the income tax payable on the total income shall pay an **additional tax @15%** on the amount declared, distributed or paid by such company **by way of dividend.**

   Company is required to pay tax on Net distributed profits. Such net distributed profits arrive after reducing the following from the accumulated profits of the company:

   - Any dividend received by the domestic company from its subsidiary
     - And such subsidiary being domestic company has paid tax on such dividend **OR**
     - Such subsidiary being foreign company has paid tax **u/s 115BBD.**
   - The amount of dividend paid to a person for or on behalf of the New Pension System Trust clause (44) of section 10.

   "10.(44) any income received by any person for, or on behalf of, the New Pension System Trust established on the 27th day of February, 2008 under the provisions of the Indian Trusts Act, 1882 (2 of 1882)"

The principal officer of the company shall be liable to pay tax on such net distributed profits within 14 days from the date of declaration of dividend **OR** distribution of dividend **OR** payment of dividend whichever is earliest **u/s 115-O(3).**

"115-O.(3) The principal officer of the domestic company and the company shall be liable to pay the tax on distributed profits to the credit of the Central Government within fourteen days from the date of—

(a) declaration of any dividend; or

(b) distribution of any dividend; or

(c) payment of any dividend,

whichever is earliest."

The tax payment shall be treated as final payment of tax in respect of amount declared, distributed or paid as dividend and no further credit shall be claimed by the company or any other person in respect of the amount of tax so paid **u/s 115-O(4).**

> *"115-O.(4) The tax on distributed profits so paid by the company shall be treated as the final payment of tax in respect of the amount declared, distributed or paid as dividends and no further credit therefore shall be claimed by the company or by any other person in respect of the amount of tax so paid."*

> No deduction shall be allowed to the company or shareholder in respect of amount which has been charged to tax **u/s 115-O(5).**

> *"115-O.(5) No deduction under any other provision of this Act shall be allowed to the company or a shareholder in respect of the amount which has been charged to tax under sub-section (1) or the tax thereon."*

Dividend Taxation

As mentioned above, domestic companies are required to pay additional tax on the payment of dividend to its shareholders'. In India such tax is called **Corporate Dividend Tax** or **Dividend Distribution Tax.** Tax at such dividend is 15% tax plus 12% surcharges and 3% education cess which comes out to be 20.35%.

Dividend received by the shareholders is exempt in their hands. However, dividend income above Rs. 10,00,000/- is attract 10% dividend tax in the hands of the shareholders.

In the present scenario, the government presented Finance Bill, 2020 which came into effect from 01.04.2020 wherein the government shifted the liability of DDT from the companies to the recipients of dividend in order to make India more attractive market for investment.

From the viewpoint of Goods and Services Act, 2017

The term dividend is not defined under GST law. In common parlance, 'dividend' means the profits of a company, not retained in the business but distributed among the shareholders in proportion to the amount paid-up on the shares held by them.

The Supreme Court in CIT v. Girdhardas & Co. (Private) Ltd. observed that the expression "dividend" has two meanings:

- As applied to a company which is going concern, it ordinarily means the portion of profits of the company which is allocated to the holders of shares in the company.
- In case of winding up, it means a division of the realized assets among the creditors and contributors according to their respective rights.

Section 17(2) of the CGST Act provides that where goods or services or both are used by the registered person partly for effecting taxable supplies including zero-rated supplies under CGST/IGST Act and partly for effecting exempt supplies (including non-taxable supplies), under the said Acts, the amount of credit shall be restricted to so much of the input tax as is attributable to the said taxable supplies including zero-rated supplies.

Further, **Section 17(3)** of the CGST Act provides that the value of exempt supply under **Section 17(2)** shall be as may be prescribed and shall include supplies on which the recipient is liable to pay tax on reverse charge basis.

It is pertinent to note that **Section 2(101)** of the CGST Act provides that "securities" shall have the same meaning as assigned to it in **Section 2(h)** of the Securities Contracts (Regulation) Act. The term 'dividend' in itself is not included in the said definition. However, it becomes relevant to examine if the earning of dividend on account of holding shares (qualifying as 'security' under the definition) is in any manner connected to the expression, "transaction in security".

In light of the above, we need to understand whether dividends can fall under the ambit of 'transaction in securities' under GST. Explanation to **Chapter V 'Input Tax Credit' of CGST Rules** provides that for the purpose of determining value of exempt supply under **<u>Section 17(3)</u>** of the CGST Act, the **value of security** shall be taken as **1% of sale value of such security.** Here, the term 'value of securities' is used in the context of sale of securities.

However, the question arises whether 'transaction in securities' should be restricted to sale of securities only or the same could extend to transactions prior to the sale of securities. Dividends are incomes earned prior to the sale of shares on account of ownership of shares held by a shareholder. Thus, a view may be taken that the payment of dividends does not amount to a 'transaction in securities' and hence, a registered person may not be required to reverse input tax credit on such dividend income under GST.

<u>Therefore the receipt of dividend does not merit input tax credit reversals under GST.</u>

<u>Conclusion</u>

From the above discussion it is crystal clear that the word dividend has different meaning under different heads and has to be treated accordingly. Further there are various areas where the word dividend needs to studied more carefully like from the view of GST as the same has not been defined by the GST Act, 2017.