

HC interprets IEPF Rules, suggests simplification & protects investor interest

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Synopsis : *This article is an analysis of the recent Delhi Court's order (dated December 5, 2017, in the matter of India Awake for Transparency v. Union of India [\[2017\] 88 taxmann.com 101 \(Delhi\)](#)). The petitioner has not questioned the validity of Section [124\(6\)](#) of the Companies Act, 2013, however, exhaustive submissions were made w.r.t. the lack of clarity in the IEPF Rules and amendments by the Circulars issued by the Central Government.*

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The article provides a background of the provisions under the Companies Act, 1956 and Companies Act, 2013, submissions made by the petitioner and the key observations of the High Court. The article concludes with the impact of the Delhi High Court ruling on the India Inc.

Introduction

1. In an interesting development, which will have an impact on India Inc. (more specifically, the listed companies), the Delhi High Court interpreted the provisions relating to 'Unpaid Dividend Account' under Companies Act, 2013. The provisions gain greater importance for Compliance Officers / Company Secretaries of the companies, as the Board authorizes them to sign the documents under Investor Education and Protection Fund Authority (Accounting, Audit, Transfer and Refund) Rules, 2016.

Provisions under Companies Act, 1956

2. Pursuant to the provisions of Section [205A](#) of the Companies Act, 1956, the companies were required to transfer the amount of unpaid dividends to a designated Account as "Unpaid Dividend Account" ('UDA'). The UDA marked such amounts as separate and not belonging to or available with, such companies. The Companies Act, 1956 also provided for transfer of funds from UDA to and Investor Education and Protection Fund ('IEPF') if no payout were made for 7 years.

Provisions under Companies Act, 2013

3. Pursuant to the provisions of Section 124(6) of the Companies Act, 2013, the companies not only retain the feature w.r.t. transfer of amounts from the UDA of all companies to the IEPF, but goes further, whereby the related shares on which dividend remains unpaid for over 7 years, would be transferred to the Fund.

Section 124(6) of Companies Act, 2013 states that 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 IEPF along with a statement containing such details as may be prescribed.

Pursuant to the provisions of IEPF Authority (Accounting, Audit, Transfer and Refund) Rules, 2016, read with Section 124 of Companies Act, 2013, the said shares shall be credited to DEMAT Account of the Authority within a period of 30 days of such shares becoming due to be transferred to the Fund. The Rules further clarify that the transfer of shares by the companies to the Fund shall be deemed to be 'transmission of shares' and the procedure to be followed for transmission of shares shall be followed by the companies while transferring the shares to the Fund.

The Rules further state that the voting rights on shares, which are transferred to the Fund, shall remain frozen until the rightful owner claims the shares. It is clarified that for the purpose of the Takeover Code, the shares which have been transferred to the Authority shall not be excluded while calculating the total voting rights (i.e. the said shall be included while calculating the total voting rights). The company shall maintain the details of shareholding of each individual shareholder whose shares have been credited to the DEMAT account of the Authority. All benefits accruing on such shares, e.g., bonus shares, split, consolidation, fraction shares etc., except right issue shall also be credited to such DEMAT account.

Petitioner's Contention

4. In a Writ Petition filed by India Awake for Transparency, following submissions were made before the High Court:

1. There is a radical change in the provisions of the Companies Act, 1956 vis-à-vis the Companies Act, 2013, i.e. if the shareholders are unable to encash their dividends for 7 years, they would face 'asset deprivation'. Terming shares as 'valuable property', the Petitioner stated that such radical change has to be carefully introduced and not in a tardy manner;
2. The share transfer mandated by Section 124(6) of Companies Act, 2013 is not limited to those holding physical scrips, but to all dematerialized shares. In the case of the latter, the demat accounts would be automatically debited or altered and the shareholding would be automatically depleted;
3. The validity of Section 124(6) of the Companies Act, 2013 was not questioned. However, the lack of clarity in the IEPF Rules and amendments by the Circulars issued by the Central Government, have resulted in confusion;
4. Petitioners argued that there is complete lack of clarity w.r.t. the 3 month period to be given to shareholders for the purpose of applying to claim their shares from the respective companies before vesting. The petitioners submitted that unless there is a mandate to the companies with appropriate consequence, the effect of Companies Act, 2013 and IEPF Rules is that the shareholders would be deprived of their valuable property without any intimation or notice.

Key Observations of the High Court

5. Below are the key observations of the High Court on the provisions relating to Companies Act, 2013 and the Investor Education and Protection Fund Authority (Accounting, Audit, Transfer and Refund) Rules, 2016, w.r.t. the unpaid dividend and the shares in relation to unpaid dividend:

1. At the heart of the controversy is the operationalisation of Section 124(6) of Companies Act, 2013 which statutorily transfers shares – which are valuable property - to the Fund in the eventuality of dividends lying unclaimed for over 7 years. What is of significance is that such shares are merely transferred for safekeeping by the Fund and do not become the property nor do they vest in the Central Government;
2. The shareholder continues to retain title but loses agency. The company concerned is relieved of the responsibility of holding the shares or reflecting it in its list of shareholders;
3. At the same time, it is not as if the existence of such shares (which are to be accounted for other purposes) is entirely obliterated. The only consequence spelt out in Section 126 of Companies Act, 2013 is transfer of dividends in relation to such shares to the Fund and keeping in abeyance any offer of rights shares and any issue of fully paid-up bonus shares;
4. The proviso to Section 126 of Companies Act, 2013 very carefully enacts that claimants of shares so transferred "*shall be entitled to claim transfer of shares from Fund in accordance to such procedure and submission of such documents such as may be prescribed.*" The Delhi High Court opined that the net result of Section 124(6) of Companies Act, 2013 is that whilst it introduces a new regime of not merely transferring the amounts lying in the Unpaid Dividend Account (referred to as 'UDA' in the judgment copy), but also directs the transfer of shares which yield unclaimed dividend for 7 years or more; it also enables the provision of a mechanism for reclamation of such shares. This aspect is to be necessarily factored in to understand the mechanics of the transfer sought to be achieved through the Investor Education and Protection Fund Authority (Accounting, Audit, Transfer and Refund) Rules, 2016;
5. The sum and substance of IEPF Authority (Accounting, Audit, Transfer and Refund) Rules, 2016 is that the companies were mandated to follow 2 crucial steps: (i) Inform the shareholders about the manner of vesting of shares and in that regard provide 3 clear months before the date of statutory transfer and (ii) Ensure that the further conditions granting relief to certain classes of shareholders who might have either in the interregnum encashed dividends or approached them to reclaim the shares, were protected.
6. As far as the non-compliance with requirement of notice by various companies goes, High Court opined that in public interest proceedings, those violations and non-compliances cannot be gone into. High Court stated that "*What is clear is that the combined effect of the first and second amendments to the Rules, results in companies becoming aware adequately in advance of their obligations, especially towards notifying the*

shareholders about the transfer. This appears to be the main grievance of the petitioner.";

7. The Court ruled that Section 124(6) of Cos. Act, 2013 does not result in a statutory vesting of any property; it merely transfers through transmission of shares in companies which have yielded dividends for seven years that have not been claimed. Such shares are then transferred to the Fund which then holds them as a custodian - in whichever manner one would wish to say it;
8. Court directed Central Government to devise appropriate procedures to enable shareholders to reclaim their property in the shares, by an appropriate procedure;
9. For the duration of transfer of the shares, the companies cannot issue bonus shares or add anything prohibited under Section [126](#) of Companies Act, 2013;
10. As far as the operationalisation of provision relates, the IEPF Rule, had the effect of giving companies adequate time to notify and comply with the 3 month public notice period to their shareholders about the event of transfer. On this the High Court noticed that the transfer of such shares or classes of shares is not a one-time measure but an ongoing event given the obligation of each company to identify such shares after the holding of every AGM;
11. It is imperative that the Central Government gives publicity to the transfer of shares, by virtue of the provisions (not of individual companies) to inform the public, and ensures a simple as well as compact form with attendant procedure is notified, for reclaiming them.

Impact of the Ruling on India Inc.

6. As discussed earlier, this judgment will have an impact on all the companies and more specifically - listed companies. Interestingly, the High Court has clarified that the shareholder continues to retain 'title' of the shares but loses 'agency'. However, the Court has also stated that the company is relieved from the responsibility of holding shares or reflecting it in its list of shareholders. Would such observation mean an amendment to the Register of Member? If yes, then how can the shareholder continue to retain 'title'?

The High Court has rightly stated that the existence of such shares is not entirely obliterated. However, such shares would be kept in abeyance for any offer of rights shares and any issue of fully paid-up bonus shares. Interesting, the High Court has held that Section 124(6) of Companies Act, 2013 does not result in a 'statutory vesting' of any property. The provisions only transfers through 'transmission of shares' in companies. The Fund holds the shares as 'Custodian'. The High Court has directed the Government to ease the provisions for reclaiming the shares transferred to the 'Unpaid Dividend Account'. In the near future, the Ministry of Corporate Affairs will again amend (for third and final time, maybe) the IEPF Authority (Accounting, Audit, Transfer and Refund) Rules, 2016 and incorporate the changes suggested by the Delhi High Court.

