LegalTalk Alert

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PricewaterhouseCoopers

Royal assent granted for the shift from a profits test to a balance sheet test for dividend payments

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Royal Assent for the Corporations Amendment (Corporate Reporting Reform) Act No 66 of 2010 was received on 28 June 2010, which amends section 254T of the Corporations Act 2001 (Cth) (Act).

As reported in *LegalTalk* on 15 December 2009, for many years Australian company law has provided that dividends can only be paid out of available company profits, which was referred to as the 'profits test'.

The amendments to the Act introduce a new three-tiered test which a company will need to satisfy in order to pay dividends. The new section 254T provides that a company must not pay a dividend unless:

- the company's assets exceed its liabilities immediately before the dividend is declared and the excess is sufficient for the payment of the dividend, and
- the payment of the dividend is fair and reasonable to the company's shareholders as a whole, and
- the payment of the dividend does not materially prejudice the company's ability to pay its creditors.

Existing directors' duties which are set out in the Act and which are designed to prevent insolvent trading will continue to apply.

The new section creates some uncertainty as the balance sheet test in section 254T(1)(a) makes reference to a dividend being 'declared'. Other sections in the Act and most modern company constitutions provide for the 'determination' of a dividend. Where a dividend is declared and a company's constitution provides for such declaration, the company incurs a debt at the time when a dividend is declared. Where a dividend is determined, the debt only arises when the time fixed for payment arises and the decision to pay the dividend may be revoked at any time before then. By referring only to the declaration of a dividend, the new section 254T(1)(a) implies that a dividend cannot be paid unless it is first declared. If this is the case, the new section will remove a company's ability to determine dividends.

Why was the Act amended?

The Act has been amended to remove the profits test due to concerns raised by the industry which included:

- no guidance or definition of the word 'profit' was included the Act which made it difficult for directors to understand the legal requirements when paying dividends
- the nature of accounting principles for the calculation of profits has changed over time and Australian accounting standards now require that a large number of non-cash expenses be included in the determination of accounting profits, and
- the profits test is inconsistent with the trend to lessen the capital maintenance doctrine.

What does this mean for your company?

Company constitutions will require review to ensure dividend provisions are not inconsistent with the new requirements in the Act. Many constitutions will contain articles drafted around the profits test which may inhibit the ability of a company to pay a dividend under the new law. In such cases, shareholder approval will be required to amend the relevant article in the constitution.

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How the Legal team can help

We can assist you in reviewing the constitutions of the companies in your group, and draft any amendments required to the constitutions as well as any applicable ASIC forms and special resolutions which may be required to effect change.

For further information please contact your usual PricewaterhouseCoopers adviser or:

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