

LegalTalk Alert

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PRICEWATERHOUSECOOPERS 



Corporate & Commercial and Financial Services Alert

Shift from profits test to solvency test for dividend payments

For many years, Australian companies law has provided that dividends can only be paid out of available profits. Industry has lobbied the government recently in relation to a number of concerns, including that:

- the Corporations Act 2001 (Cth) (Act) does not provide guidance about or define the term 'profits'
- the common law principles in relation to the determination of profits are outdated and not consistent with International Financial Reporting Standards now applicable in Australia, particularly where non-cash expenses must now be brought to account.

The Corporations Amendment (Corporate Reporting Reform) Bill 2010, released on 4 December 2009, proposes to repeal the profits test in s 254T of the Act and introduce the following three-tiered test which a company will need to satisfy to pay dividends:

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

Existing provisions in the Act relating to a director's duty to prevent insolvent trading will continue to apply in the context of dividend payments.

The first limb of the test is consistent with current law in relation to dividend payments in Canada and New Zealand. The second two limbs of the test are consistent with the current provisions in the Act relating to capital reductions and buy-backs.

The proposed amendments will allow a company to pay dividends to shareholders that include share capital. Amendments will likely be required to taxation legislation to ensure that current principles relating to the taxation of dividends are not affected by this proposed corporate law change (for example, to ensure that franking credits cannot be attached to the dividend to the extent the dividend is sourced from a source other than profits).

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