Unlocking shareholder value
Dividend planning and management
June 2015

In a tight market for capital, investors are demanding a higher dividend yield for the price of their investment. Dividend payout ratios are rising as companies look to maximise shareholder value and meet investor expectations.

In practice, paying a dividend is not straightforward. We share our insight in this publication on the hurdles faced by companies paying dividends, and key considerations to paying a dividend.

Why does paying a dividend require careful consideration?

A dividend may only be paid by an Australian entity if specific requirements are met.

Section 254T of the Corporations Act 2001, common law and each company’s respective constitution govern the ability of companies to pay a dividend to shareholders. The operation and interpretation of the law means that corporate structures with multiple companies need to consider carefully the legal, accounting and tax interplay when setting dividend policies and paying dividends to shareholders.

A company’s ability to pay a dividend is assessed on a single entity basis. As such, while a company might be part of a tax consolidated group for income tax purposes (whereby intercompany transactions are generally ignored and the franking credits reside with the ‘head company’), the entity proposing to make a distribution will still need to meet the requirements outlined above. This means that despite recording healthy profits across the group, the legal and accounting interactions can still result in dividend ‘traps’ in complex corporate structures.

Below are some common “symptoms” that we have seen in companies that suggest an incapacity to pay dividends:

- **Policy or plan to pay franked dividends where no current profits available**
- **Negative retained earnings at the date of the proposed dividend**
- **Fixed dividend payouts that may exceed profits**
- **Profits residing in subsidiaries that are carried at or close to fair value**
- **Pressures on impairment**
What if a company has paid a dividend that doesn’t satisfy the requirements?
The consequences of such a payment will depend on the particular circumstances, but may include that:

• the dividend is treated as an unauthorised return of share capital;
• the dividend is characterised as a loan; and/or
• there has been a contravention of the Corporations Act or common law.

It should also be noted that any such distribution is unlikely to be “frankable” for tax purposes.

Case studies of Australian companies which exhibited “symptoms”
Consider the scenarios below where the company would not have been able to pay a dividend legally without taking the “Actions” we recommended:

1. Target sub-group acquired

   | Listed Co |
   | Op Co     |
   | Subs      |
   | Existing Sub Group |

   | New Co |
   | Subs |
   | Target Sub Group |

   Tax consolidated Group

   Situation
   • ASX listed company
   • History of paying franked dividends
   • Recent acquisitions, including Target Sub Group
   • Customers migrated from Target Sub Group to Existing Sub Group
   • Market expectations of future franked dividends.

   Problem
   • Impairment of investment in Target Sub Group
   • Dividend block in Listed Co would prevent dividends to shareholders.

   Actions
   • Transfer of assets, restructure of debt and equity in group.

   Outcomes
   • Additional profits in Listed Co
   • No future dividend blocks
   • Unnecessary subsidiaries ready for liquidation.

2. Negative retained earnings

   | Listed Co |
   | Subs |
   | Subs |
   | Subs |
   | Subs |

   Tax consolidated Group

   Situation
   • ASX listed company
   • History of paying franked dividends
   • Recent acquisitions and rapid growth

   Problem
   • Listed Co had negative retained earnings
   • Profits at group level but Subs never distributed to Listed Co
   • No tax accounting in Subs
   • Franking credits should not have been distributed to shareholders

   Actions
   • Reconstruction of stand alone legal entity accounts
   • Restructure of intercompany debt
   • Profit distributions via intercompany dividends
   • Disclosure to regulators

   Outcomes
   • Profits in Listed Co for future dividends
   • No future dividend blocks
   • Unnecessary subsidiaries ready for liquidation
   • Practical risk for historical dividends mitigated

How we can help...

The tax, legal and accounting interplay
Sustainable dividend policy must not only maximise shareholder value, it must address risk and be in full compliance with legal and regulatory requirements.

It is important that CFOs and their finance teams work collaboratively with their tax, legal and accounting advisers to ensure their corporate structure operates efficiently and does not affect the ability to pay dividends or maximise yield and value for shareholders.
Our Dividend Solutions Team

• We’ve worked closely with a number of companies to unlock value for their shareholders.
• Optimum dividend management requires an understanding of the tax, legal and accounting requirements and the interactions between them. Our Dividend Solutions team brings together experts in these areas to find solutions for flowing dividends through complex group structures and maximising the ability to pay dividends to shareholders.
• We analyse financial accounts, group structures and dividend policies within the framework of legislative requirements, accounting standards, reporting requirements and market expectations.
• For more information, speak to your usual PwC contact or one of our Dividend Solutions team.