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CORPORATIONS REFORM – NEW SHARE DIVIDEND RULES

On 10 April 2014, The Treasury released an Exposure Draft of legislation which proposes further changes to the rules governing payment of share dividends.

Under the proposed amendments, the payment of dividends would be exempted from the share capital reduction rules in the *Corporations Act 2001*, increasing the flexibility of companies to pay dividends.

Current Requirements

Section 254T of the *Act* controls the circumstances in which dividends may be paid by a company, and has been the subject of reform on several occasions in recent years. It originally provided that dividends could only be paid out of profits ('profits test'). The current 'net assets test' came into effect in June 2010.

In its current form, the legislation provides that dividends may only be paid where:

1. Assets of the company exceed its liabilities and, immediately before the dividend is declared, the excess amount is sufficient for the payment of the dividend;
2. Payment of the dividend is 'fair and reasonable' to company shareholders as a whole; and
3. Payment does not materially prejudice the company's ability to pay its creditors, particularly where payment of the dividend would cause the company to become insolvent.

Practical Difficulties with 'Net Assets'

In November 2011, The Treasury released a Discussion Paper considering the effectiveness of then recently-implemented 'net assets test'. It identifies a number of prevailing concerns with the current approach.

Most significantly, it identifies the 'assets greater than liabilities' requirement as being problematic for businesses, often proving to be both an inaccurate measure of solvency and placing an unreasonable compliance burden on smaller companies.

Overview of Proposed Amendments

Amendments proposed in the draft Bill would adopt key recommendations of the 2011 Treasury Discussion Paper, including replacement of the existing 'net assets test' with a 'solvency test'.

The new test provides that directors of a company may pay a dividend if they reasonably believe the company will remain solvent if a dividend is paid.

The proposed test would also discard the requirement for company directors to consider whether payment of a dividend is 'fair and reasonable' to shareholders.

Overall, the test is simpler, although a director must still exercise caution when considering solvency issues.

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Position Clarified – Paying Dividends from Capital

The draft Bill would also clarify whether payment of dividends otherwise than out of profits is a capital reduction which requires shareholder approval in accordance with Chapter 2J of the *Corporations Act 2001*.

Though it is debateable whether the legislation raises significant questions in this respect, the proposed amendments resolve any potential ambiguity by inserting a new section 254TA which expressly provides for the reduction of share capital by payment of a dividend, in most circumstances without the need for shareholder approval.

Tax Implications for Investors

According to the explanatory material accompanying the Exposure Draft, the proposed amendments are not intended to affect tax implications for investors. Share capital reduction by way of dividend payments to shareholders will generally be classified as a return of share capital to the shareholder rather than a 'dividend' and therefore would be taxed under capital gains provisions.

Seek professional advice from accounting professionals for advice on this topic.

Conclusion

The consultation period concluded on 16 May 2014, with Treasury receiving a total of 19 submissions.

By and large, those making submissions are in favour of the simplified solvency test proposed for s 245T dividend provisions, including a number of major industry and interest groups, notably the Australian Institute of Company Directors (AICD), Governance Institute of Australia (GIA) and Australian Shareholder's Association (ASA). It appears there is limited support for the proposed s 254TA, particularly among financial services industry sector groups.

If the proposed amendments become law, companies will be empowered to pay dividends more freely, providing added flexibility in their dealings.

In light of this, company directors may want to consider reviewing dividend payment provisions of their constitutions and/or shareholder agreements to take full advantage of diminished restrictions.

For further information about directors' duties, corporate governance, corporate restructuring, or similar topics, please contact:

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