



# Changes to Payment of Dividends and Structuring Contingency Solutions

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The *Corporations Amendment (Corporations Reporting Reform) Act 2010* (Act) came into effect on 28 June 2010.

Previously, Section 254T of the *Corporations Act* provided that a corporate entity could only declare and pay dividends out of its profits. The Act implemented a number of changes to the *Corporations Act 2001* (Cth) 2001 including changes to how dividends can be declared and paid by a corporate entity.

What follows is an overview of how the proposed changes to dividends may affect shareholders in respect to succession planning of an Enterprise in assessing Liabilities of the Corporate entity in the event of Retirement, Illness or Death.

## Changes to Dividend Payments

The Act has amended Section 254T of the *Corporations Act* to replace the 'profits test' with a new test that requires the following conditions to be satisfied before a company can declare and pay a dividend:

- *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.*

For the purpose of determining whether the assets of a corporate entity exceed its liabilities, the corporate entity must calculate its assets and liabilities in accordance with accounting standards in force at the relevant

time (even if the standard does not otherwise apply to the financial year of some or all of the corporate entities concerned).

Additionally, in determining whether or not the above conditions are satisfied, directors of a corporate entity should bear in mind their overriding duty (under Section 588G of the *Corporations Act 2001*) to prevent the corporate entity from insolvent trading.

In particular a debt may be incurred when a dividend is paid or when a redeemable preference share is paid.

## Possible Succession Planning Implications

The proposed changes give corporate entities greater flexibility to pay dividends provided that conditions stated above are satisfied. For example, a corporate entity may with sufficient net assets but insufficient profit be able to pay a dividend.

But here lies a major problem in respect to Succession Planning. It may be that a corporate entity is "Asset Rich" but not making sufficient profits due to the slowing down of the Principal or poor succession management (without equity succession) to a new generation family member. In such instances poor treasury planning including capital extraction may slowly dilute the capital from the corporate entity, without sufficient future profits. Overtime the value of the corporate entity may slowly be depleted.

## Other Implications

This change has the reverse impact in that if a corporate entity does not have sufficient net assets, but has profits, it will not be able to declare a dividend.

The assets and liabilities test may impose an additional accounting burden on small proprietary companies. Small proprietary companies are not, other than in certain circumstances, required under the *Corporations Act* to prepare accounts that



comply with the Australian Accounting Standards. If a small corporate entity wants greater certainty that its assets exceed its liabilities, it may need to seek professional advice which would, necessarily, involve further expense.

Most standard constitutions for companies have a clause that only permits payment of dividends out of the profits of the corporate entity.

Should a client wish to take advantage of the amendments to the Section 254T of the *Corporations Act*, the client may need to amend the terms of the constitution of your corporate entity to mirror the changes to Section 254T.

Note that as a result of the amendment to section 254T of the Corporations Act section 44 of the Income Tax Assessment (1936) was amended to ensure that such a dividend is taken to be paid out of profits for income tax purposes.

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Melinda Wood – ili Enquiries (02) 9251 3611 [enquiries@ili.com.au](mailto:enquiries@ili.com.au)**