Grant Thornton

Technical Accounting Alert

Changes to Dividend Laws

Introduction

The purpose of this alert is to provide details of the changes to the dividend laws and potential consequences as result of the Corporations Amendment (Corporate Reporting Reform) Act 2010 obtaining Royal Assent on 28 June 2010.

Overview

The existing 'profits' test for paying dividends (s.254T of the Act) has been repealed and replaced with a three-pronged solvency test which requires:

(1) The company's assets to exceed its liabilities immediately before the dividend is declared and the excess to be sufficient for the payment of the dividend;

(2) It is fair and reasonable to the company's shareholders as a whole; and

(3) It does not materially prejudice the company's ability to pay its creditors.

The above test is required to be applied at the time the dividends are declared and paid. Therefore the assets and liabilities need to be calculated in accordance with the accounting standards in force at the time which is applied by the company. This will result in company's not being able to just rely on half-year or annual accounts, but will need to establish financial accounting processes to be able to determine their updated net asset position at both points of time, although where there are sufficient assets and no major economic changes to the company, this should not be difficult to document

In addition to the above amendments, there have been consequential amendments to the ITAA, to ensure that all dividends paid by a company pursuant to these amendments will be deemed to have been paid out of profits and will, therefore be assessable income of the shareholders.

There have been a number of potential issues identified, that companies need to consider in transitioning to the new laws. These are as follows:-

Constitutions

Many companies have specific restrictions in their constitutions that dividends can only be paid out of profits. These restrictions continue to apply despite the change in the law. If companies want the ability to pay dividends in excess of profits, they should amend their constitution by shareholder special resolution to remove the profits test restriction.

This will generally require a general meeting to be held. With the AGM season fast approaching, companies will need to consider any implications requiring amendments to their constitution.

Accounting review

Boards will need to put in place processes to be able to determine the net asset position of the company and ensure that the three tiers of the solvency test are satisfied, not only at the end of the financial year or half year, but at the time that the dividends are declared and paid. This will need to include such reporting period adjustments applied by the company, such as fair value adjustments (e.g. mark-to-market for derivatives), asset impairment write-downs, and revaluations of investment properties.

Companies not required to prepare financial reports

There are a number of companies/entities that are not required to prepare financial reports under the Corporations Act (e.g. most small proprietary companies), and therefore their financial reports prepared are generally of a special purpose nature, and do not necessarily apply any or all of the recognition and measurement principles under the Australian Accounting Standards. The intent of the legislation was that is should be only the accounting standards that are applicable to the company that are to be applied for the purposes of calculating a dividend, and hence it is not necessary to adjust for accounting standards that are not relevant or applicable to the company (ie differential reporting or standards issued but not yet effective). This is an issue that the Government has agreed to urgently re-look at after the election, and it is hoped that the whole assets restriction test will be re-considered as its inclusion complicates further what was intended to be purely a solvency test without any IFRS complications.

Change in accounting policies and/or standards

As noted above, the company's net assets are determined in accordance with accounting standards that are applicable to the company which are in force at the relevant time. This may cause potential issues if the 'net assets' test is met at the date the dividend is declared, but because of a change in applicable accounting standards and/or policies is not met at payment date.

Further information

For further information on any of the information included in this TA alert, please contact your local Grant Thornton Australia contact member or a member of the National Audit Support team via the GTAL IT Service Desk http://gtassist.au.gt.local/