

## Corporate & Commercial Client Alert

6 July 2010

### **Requirements for paying dividends Corporations Amendment (Corporate Reporting Reform) Act 2010 No. 66**

The Corporations Amendment (Corporate Reporting Reform) Act 2010 (Cth) ("**Act**") was assented to on 28 June 2010. The Act amends section 254T of the Corporations Act 2001 (Cth) effective 28 June 2010.

Prior to being amended by the Act, section 254T of the Corporations Act 2001 (Cth) provided that a dividend was only payable out of company profits. This is commonly referred to as the "profits test". Section 588G of the Corporations Act sets out a director's duty to prevent insolvent trading.

On the 28 June 2010 the profits test was repealed and replaced with a more flexible requirement that allows a company to pay dividends if:

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

The existing directors' duty to prevent insolvent trading in section 588G of the Corporations Act continues to apply under the new law. Directors must ensure that there are no reasonable grounds for suspecting that the company will be rendered insolvent as a consequence of paying or declaring a dividend.

The new law addresses industry concerns that the Corporations Act 2001 (Cth) does not provide guidance on what is meant by the term "profits" and that the requirement to pay dividends only out of "profits" is inconsistent with the trend to lessen the capital maintenance doctrine in Australia. The new law will enable companies to pay dividends if it has sufficient cash to do so despite accounting profits being eliminated by non-cash expenses.

The new law applies in relation to dividends declared on or after 28 June 2010.

Companies should review their constitution and amend if necessary to ensure that the dividend provisions in their constitution are consistent with the new law and that the company is not unnecessarily restricting its ability to pay dividends.

The Act implements a number of other important changes to the corporate regulatory framework. These include changes to the reporting obligations of companies limited by guarantee, changes to when entities must prepare separate financial statements where consolidated statements are required, and changes that permit (in limited circumstances) a variation to the length of an entity's financial year.

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