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CLIENT UPDATE

CORPORATE INSOLVENCY RESTRUCTURING FORENSIC ACCOUNTING

Directors beware - new test governing Payment of Dividends

The Corporations Amendment (Corporate Reporting Reform) Act 2010 introduced an important amendment to Section 254T of the Corporations Act, which governs the circumstances in which companies may pay dividends after 28 June 2010.

Previously, a company was only entitled to pay dividends from profits; now there are new rules to consider.

New Rules

The new section 254T replaces the profits test with a 3-tiered test, which provides that a company must not pay a dividend unless:

- the company's assets exceed its liabilities immediately before the dividend is declared and the excess is sufficient for the payment of the dividend;
- 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.

Assets and liabilities for this purpose are to be calculated in accordance with accounting standards in force at the relevant time.

The Government considers that the reform will enhance the flexibility to pay dividends, but it may also increase red-tape for small proprietary companies. Additional work may be required by these companies to ensure the calculation of assets and liabilities is done in accordance with the accounting standards.

Practical Implications

The changes to the Act mean the legislation has moved away from a 'capital maintenance' to a 'solvency based' approach. This means that dividends may be paid **other than** out of profits.

In many instances, if companies want to maintain maximum flexibility in the payment of dividends, the constitution of the company may need to be amended to allow for payment of dividends other than out of profits.

Advice

It is our advice that the broadening of the base from which dividends can be paid opens up risks that directors should be conscious of.

Therefore, we recommend that great care should be taken by any company paying a dividend out of a source that is not retained profits, to avoid the payment reducing the company's liquidity to such an extent that it threatens its solvency.

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Sole Directors - make sure you have a Will

In a recent matter, we experienced the difficulty that resulted from a sole director/shareholder who died without a Will in place.

The sole director/shareholder had an insolvent personal estate, but his company had net assets (subject to the costs of realising those assets) that would have been available to distribute to the estate.

The quandary was how to get the company into liquidation. The liquidation would have facilitated company creditors being paid and the possibility of a distribution to the director's estate.

The options were:

- for the director's widow to make an application for a grant of probate and then a further application to wind up the company; or
- for a creditor to make an application to have the company wound up.

In both cases, the costs of taking the necessary action outweighed the risks and benefits of applying for the liquidation, and the matter remained unresolved.

A resolution would have been simpler if the deceased director had a Will passing the shareholding in the company to a person who would have then been able to voluntarily wind up the company at comparatively little cost.

The learning we take from this experience is that while it is always very important to have a valid Will, it is even more important to have a Will if you have a more complicated estate that includes companies.

About us

Heard Phillips aims to be the first choice for critical SME insolvency, restructuring and forensic accounting matters in South Australia.

Our firm seeks to deliver superior quality outcomes for clients through our credible and reliable practitioners, who take pride in displaying the highest level of respect to all stakeholders.