

Update

Corporate & Commercial

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Payment of dividends by companies

What you need to know

- Changes under the Corporations Amendment (Corporations Reporting Reform) Act 2010 (the Act) have now commenced.
- The rules for payment of dividends by companies have changed.
- You may need to consider updating constitutions for your companies, which may contain restrictions on payment of dividends that are no longer applicable.
- The constitution for your company may no longer be in line with company law – it may provide that a dividend can only be declared and paid from profits. If so, by making a change to your company's constitution you may be able to pay dividends in other circumstances now permitted by the Corporations Act.

Payment of dividends other than out of profits

Previously, a company was entitled to pay dividends only from profits. The Act has been changed so that a company is now restricted from paying dividends 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; 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.*

What the change means in practice

By the change the requirements have moved away from a "capital maintenance" to a "solvency based" approach. This means that dividends may be paid other than out of profits.

The changes made to the Corporations Act 2001 (Cth) (**Corporations Act**) may permit payment of dividends:

- by companies in start-up (without accounting profits); or
- where profits have been affected by non-cash expenses (such as depreciation),

among others.

In contrast, a company that has recorded a profit, but which has a deficiency in net assets will no longer be able to declare a dividend to its shareholders.

Restriction on payment of dividends by companies limited by guarantee

Further, the Corporations Act now contains an express prohibition that prevents a Company Limited by Guarantee from distributing dividends to members.

Other changes

Finally, companies limited by guarantee may now be classified as "small" and "large" companies under the Act with different reporting requirements (as is currently the case for proprietary companies).

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