

27 January 2012

The Manager
Corporate Reporting and Accountability Unit
Corporations and Capital Markets Division
Australian Treasury
Langton Crescent
PARKES ACT 2600

By email: corporatereportingreforms@treasury.gov.au

Dear Sir/Madam

DISCUSSION PAPER - PROPOSED AMENDMENTS TO THE CORPORATIONS ACT

BDO welcomes the opportunity to provide a submission on the *Discussion Paper - Proposed Amendments to the Corporations Act* (the Discussion Paper), released for public consultation on 28 November 2011.

Our submission on the issues raised in the Discussion Paper is attached as an Appendix.

Should you have any questions, or wish to discuss any of the comments made in the attached submission, please do not hesitate to contact me on (02) 9286 5527.

Yours sincerely



Matthew Wallace
National Tax Counsel
Corporate and International

APPENDIX

This document sets out the submission of BDO in relation to the *Discussion Paper - Proposed Amendments to the Corporations Act* (the Discussion Paper), released for public consultation on 28 November 2011.

Unless otherwise indicated, statutory references are to the *Corporations Act 2001*.

Executive Summary

As explained below, we make the following submissions in respect to the Consultation Paper:

- The current formulation of s254T fails to adequately identify the funds out of which a company is authorised to pay dividends. A court, called upon to interpret s254T, might well conclude that companies remain constrained to pay dividends only out of profits. If companies are authorised to pay dividends out of share capital, and in doing so, are not constrained by the provisions of Chapter 2J, this must be made explicit in the legislation.
- The current conditions imposed under s254T for payment of a dividend are inappropriate to the extent such dividend is funded out of the profits of the paying company.
- The current formulation of s254T inappropriately and unnecessarily restricts the payment of dividends from current year profits.
- The current formulation of s254T imposes material compliance costs on companies not otherwise required to prepare accounts in accordance with accounting standards.
- To the extent that dividends are paid out of share capital, the safeguards of the interests of creditors and other shareholders implicit in the current conditions imposed by s254T are appropriate.
- A return to payment of dividends only out of profits is probably now impracticable.
- The condition in current s254T(1)(a) is inappropriately limited to “declaration” of dividends.
- Of the options for reform posited in the Discussion Paper, Option 4 best addresses our concerns. However, this option would require further reforms to address our concerns about:
 - Explicit identification of the funds out of which a company is authorised to pay a dividend; and
 - The condition in s254T(1)(a) being limited in its application to “declaration of dividends”.

Detailed submissions

1. Deficiencies in existing s254T and other design factors

In order to comment on the manner in which s254T should be amended (or not), it seems prudent to first articulate the deficiencies, real or perceived, that are present in its current formulation. The elements of each of Options 1 to 4, described in the Discussion Paper, or other solutions that address those deficiencies, can then be identified.

We have also sought to identify what have now become expected elements of the dividend provision, which could not be abandoned without considerable inconvenience and cost.

2. No explicit identification of funds from which a company is authorised to pay dividends

The replacement of the then existing s254T by the *Corporations Amendment (Corporate Reporting Reform) Act 2010* was presented as a solution to problems arising in the application of the previous s254T, which provided:

“A dividend may only be paid out of profits of the company.”

In particular, it was suggested that the new s254T overcame the problem of identifying what were profits of the company, for that purpose. It might be noted that the previous iteration of s245T both identified the authorised source of the funding of dividends (profits) and limited the source of dividends to that same source of funds. Arguably the current s254T introduced its own problems in respect of the identification of funds available for payment of a dividend.

Current s254T is formulated as a prohibition, rather than an authorisation. While it prescribes the conditions which must be present after the payment of a dividend, it is, in fact, silent on the question of the funds from which such dividend may be paid. There is a real risk that a court called upon to interpret existing s254T, particularly in light of the long history, under company law, of the differential treatment of dividends, paid out of profit, on the one hand, and return of capital to shareholders, on the other, would interpret s254T as still requiring that dividends be paid out of profit. This risk is exacerbated by the separate and different requirements, under Chapter 2J, for the return of capital by a company to its shareholders.

Regardless of the approach adopted otherwise, if it was indeed intended that the section authorise payment of dividends out of share capital this should be explicitly authorised in the provisions of the section. This might be accomplished with a provision such as the following:

“Subject to the following subsections, a company may pay dividends from any funds available to it, including share capital.”

In addition, it might be prudent to provide statutory confirmation that the separate requirements for return of capital to shareholders, in Chapter 2J, need not be followed, in respect of a dividend, to the extent that it is paid out of share capital.

There would also be an argument that such amendments should be retrospective in application to the time of the 2010 amendments to s254T in order to address payments of “dividends” out of share capital that have been made as a consequence of such changes and the representations made in respect of such changes in the accompanying Explanatory Memorandum.

The concerns that we have voiced about the funds available for payment of a dividend are not unique. In this regard we refer to draft Taxation Ruling TR 2011/D8 and the joint opinion of A H Slater and J O Hmelnitsky made public by the Australian Taxation Office (ATO) in the context of the release of such draft ruling.

3. Imposition of inappropriate conditions when dividend, in fact, paid out of profits

The current form of s254T includes conditions that must be present after the payment of a dividend which were drawn from the return of capital provisions in Chapter 2J. Thus, in addition to the requirement that the dividend not exceed the net assets of the company, s254T(1) imposes requirements that:

“(b) the payment of the dividend is fair and reasonable to the company’s shareholders as a whole; and

(c) the payment of the dividend does not materially prejudice the company’s ability to pay its creditors.”

These requirements do not seem warranted where a dividend is funded out of profits. In particular, the requirement that the dividend be fair and reasonable to the shareholders as a whole would seem to be problematic in light of the capacity of companies to pay differential dividends to shareholders. In this regard s254W(2) should, in particular, be noted.

4. Unintended restrictions on payment of dividends out of current year profits

Prior to the changes to s254T, it was possible for a company to pay a dividend out of current year profits notwithstanding that after the payment of such dividend the book value of assets did not exceed the book value of liabilities. This was, of course, subject to the proviso that, by reference to s588G, this did not result in the company being unable to pay its debts as and when they fell due. The availability of current year profits for this purpose was made clear in cases such as *Glenville Pastoral Co Pty Ltd v FCT* (1963) 109 CLR 199 and *Marra Developments Pty Ltd v B W Rofe Pty Ltd* [1977] 2 NSWLR 616. The payment of such dividends can be precluded by the current s254T, however.

The limitation of the availability of such “nimble dividends” can have material consequences for corporate groups. Thus in passing profits up a chain of companies by way of dividend, a company in the relevant chain with accumulated losses could preclude such profits reaching ultimate shareholders, even where there were no solvency concerns. It should be noted that the Explanatory Memorandum in respect of the 2010 amendments to s254T did not identify this

circumscription of funds available for the payment of dividends as one of the intended policy outcomes of such amendments.

The exclusion of dividends paid out of profits from any additional restrictions imposed by s254T would address this concern. Thus such additional restrictions could be prefaced by the words:

“Except to the extent that dividends are paid out of profits...”

5. Inappropriate requirement to apply accounting standards where not otherwise required

Under the terms of current s254T, in order to pay a dividend, a company must determine that there is a sufficient excess of assets over liabilities, with such amounts being determined by reference to accounts prepared in accordance with applicable accounting standards. This, thus, practically, imposes an obligation on all companies, including smaller companies which would otherwise not be required to do so, to prepare accounts in accordance with such standards. This imposes material and unwarranted compliance costs on such smaller companies.

This concern would be substantially addressed by the exclusion of the payment of dividends out of profits from such requirements.

6. To the extent that dividends are paid out of share capital, restrictive safeguards are warranted

There have long been material restrictions on the return by a company of capital to shareholders. These have been largely aimed at protecting the interests of creditors of a company and, in particular, maintaining the priority of the repayment of the amounts that such creditors advanced over the return of capital to shareholders. It follows that, to the extent that s254T authorises payment of dividends out of share capital, the restriction imposed by current s254T(1)(c) is warranted.

The possible situation of capital contributed by one group of shareholders being used to fund dividends paid to another group of shareholders would similarly, to the extent s254T authorises the payment of dividends out of share capital, warrant the restriction imposed by current s254T(1)(b).

7. Forgoing authorisation of the payment of dividends out of the surplus of the assets of a company over its liabilities now impracticable

Due to:

- The problems with the previous iteration of s254T which were cited as the motivation for the repeal of that section and its replacement by the current iteration of s254T, and
- The systems and procedures, based around payment of dividends out of the surplus of the value of assets over liabilities, that have been adopted by companies in response to the enactment of the current iteration of s254T,

it would seem impracticable to return to a rule which restricted the source of dividends only to “profits” of a company.

8. Inappropriate restriction to declaration of dividends

The current iteration of s254T(1)(a) requires that “*the company’s assets exceed its liabilities immediately before the dividend is declared*”(emphasis added). Framed thus, the provision does not appropriately address dividends which are paid without declaration, which is the norm under s245U and most company constitutions (and was previously often the case in respect of interim dividends). This could be addressed by substituting the words “*first to occur of payment or declaration of the dividend*” for the current “*dividend is declared*”.

9. Addressing the reform options posited in the Discussion Paper

Having regard to our submissions, set out above, the options for reform of s254T posited in the Discussion Paper can be addressed as follows:

- Option 1 (retaining s254T as drafted) would be unsatisfactory, having regard to each of points 2 to 5 (inclusive) and point 8 of our above submissions;
- Option 2 (adopting a solvency test) would, without more, fail to address points 2, 4, 6 and 8 of our above submissions;
- Option 3 (reinstating a profits based test) would, without more, be contrary to point 7 of our above submissions;
- Option 4 (adopting new arrangements under which a company would have two ways of determining whether it could pay a dividend) would address our concerns, provided measures were also introduced to address points 2 and 8 of our above submissions.