MEMO

To: Board of Directors

From: Company Secretary

Subject: **DIVIDEND – ISSUES TO CONSIDER**

You have asked for my comments on the issues/process for paying a dividend to shareholders.

As I see it the key issues/matters for consideration include:

1. Dividend source

Dividends can only be paid out of a company's profits [Corporations Act s.254T].

"Profits" are not defined in the Act, but there have been many cases on the matter and the consensus is that it is the amount shown in the Profit & Loss Account as determined by applicable accounting standards.

It is common for companies to pay an interim dividend based on the first half-year's financial results (profit after tax), and a final dividend following compilation of the full financial year's results.

2. Franked dividends

If a dividend is being paid in respect of profits on which the company has paid corporate tax (at its applicable rate), the company will usually be entitled to 'frank' the dividend to the extent of that tax paid under the dividend imputation rules.

The shareholder who receives the dividend can then offset any tax he might otherwise pay by the amount that the dividend has been franked (and so if he is on a higher marginal tax rate he gets the benefit of an imputation credit equal to the corporate tax rate paid – which is the maximum tax applicable to that portion of his income).

The extent to which a dividend is franked must be declared before the dividend is paid, and must be advised to shareholders on the dividend payment notice.

The Income Tax Assessment Act covers all applicable legislative requirements about the calculation, franking, payment and tax aspects of dividends.

3. Declaration of dividends

A Replaceable Rule in the Act [s.254U] provides that the directors may determine that a dividend is payable and fix the amount and payment date.

Similarly, in most company constitutions the board of directors can declare and pay dividends, although some constitutions require that shareholders in general meeting must approve dividends (usually on the basis of the directors' recommendation).

Directors cannot declare or recommend (to shareholders) a dividend if payment would result in the company being unable to pay its debts.

Suggested resolution:

> **RESOLVED** that a dividend of 1.2¢ per ordinary share, fully franked, be paid on 5 October 2010 to all eligible shareholders as at the record date of 28 September 2010.

If shareholders are to approve a dividend it is most commonly done at the AGM when, amongst other things, the company's financial statements are laid before members.

4. Dividend rights

Sec.254W of the Act requires that, in a <u>public company</u>, each share in a class of shares has the same dividend rights, unless the company's constitution provides otherwise or the shareholders in general meeting agree by special resolution.

But in a <u>proprietary company</u> directors may generally pay dividends as they see fit, subject to the constitution and/or terms on which the shares were issued.

5. Set "record date" & "payment date"

When announcing a dividend payment we will need to set a "record date" – the date at which shareholders who are recorded on the register at the close of business that day are those who are entitled to receive the dividend. The stock exchange requires a minimum 7 business days between the dividend announcement date and the "record date", to give adequate time for share transfers to be processed. However, if a shareholder has bought shares but is not on the register (i.e., his transfer has not yet been processed) as at the "record date" he will miss out on the dividend on those shares.

All shares acquired (and/or entered into the register) after the "record date" will not receive the dividend.

We should at the same time announce the dividend "payment date". The stock exchange requires that notification of the details of a dividend payment must be despatched within 10 business days after the actual "payment date".

6. Method of payment

Subject to any constitutional constraints, a dividend can, if the directors/shareholders so resolve, be paid in cash, by the issue of shares or grant of options (e.g., dividend re-investment plan), or in specie (e.g., by distribution of company assets).

7. Cash payment – direct credit or cheque

Payment of dividends can be by company cheque, but most commonly is done via direct credit to a shareholder's bank account.

Whichever method, we should undertake a mail-out now to collect bank details, and from now on whenever anyone becomes a shareholder we should obtain that information.

8. Tax File Numbers

Public companies are required to ask investors to quote their TFN (ITAA sec. 202D), and then record it; but it is not an offence to not quote a TFN.

However, if investors have not quoted a TFN (or an exemption) companies are obliged to deduct a 'resident withholding tax' on the portion of a dividend which is unfranked, and remit that to the ATO.

9. Withholding tax / non-residents

Under the pay as you go (PAYG) system, non-residents are liable for Australian tax on all assessable income earned in Australia, including dividends. The amount of tax payable depends on whether the recipient is a resident of a country that has a tax treaty with Australia.

The dividend does not have to be actually paid to the non-resident to be subject to tax. If the income is re-invested, accumulated, capitalised or otherwise dealt with on behalf of the non-resident, or as the non-resident directs, it is deemed to be paid.

Companies generally withhold tax from dividends paid to non-residents. However, trustees, agents or others who receive dividends on behalf of a non-resident, where withholding tax has not been withheld by the payer, are required to withhold tax themselves at the relevant non-resident rates.

Dividends paid to non-residents are subject to the dividend imputation rules. The tax treatment of a dividend depends on whether it has been franked. The company paying the dividend is required to issue a statement indicating whether the dividend is franked. If a dividend has been fully franked, it has had income tax taken out of the company's profits before the dividend is paid to a shareholder and no further tax has to be paid on it in Australia.

If however a dividend is partially or completely unfranked, the payer must withhold tax from the unfranked amount before paying the dividend to the non-resident shareholder. A company is required to withhold amounts from unfranked dividends if:

- (according to the register of the company's members) the entity, or any of the entities holding shares on which the dividend is paid, has an address outside Australia, or
- the company is authorised to pay the dividend to an entity or entities at a place outside Australia.

Non-resident tax must be withheld when:

- the unfranked dividend is actually paid, or
- the unfranked dividend is credited to the account of the non-resident or otherwise dealt with on behalf of, or at the direction of, the non-resident.

The amount of tax that must be withheld on the unfranked portion of dividends paid to non-residents is usually 15%, but sometimes 30%. However, tax agreements with some countries may vary the rate on dividends in particular circumstances. This withheld tax must be remitted to the Australian Tax Office and the company must lodge a *PAYG Withholding from Interest, Dividend and Royalty Payments Paid to Non Residents* annually.