Company Law: Back to Basics - Dividends

[00:00:01.940] - Suzanne Kearney, Of Counsel

In today's episode, we're going to focus on dividends, the requirements to be satisfied in order to pay a dividend, who dividends are paid to, and the consequences of paying an unlawful dividend. I'm Suzanne Kearney, Of Counsel in the Corporate and M&A Department in Arthur Cox.

[00:00:19.020] - Tom Courtney, Partner

And I'm Tom Courtney, partner here at Arthur Cox.

[00:00:21.920] - Suzanne Kearney, Of Counsel

When we look at dividends, it is often within the broader context of distributions, which can generally be summarised as any transfer of value from a company in favour of its shareholder or shareholders. It is a fundamental rule of Irish company law that a company may not make a distribution other than out of its distribution profits. A dividend is probably the most obvious type of distribution and the one we are going to focus on today but it is important to bear in mind there are many other forms of distribution.

[00:00:50.310] - Tom Courtney, Partner

Another point to highlight at the outset is that many of the provisions relating to the declaration and payment of dividends under the Companies Act 2014 are optional provisions. We recorded an earlier episode in this series focusing on optional provisions but regular listeners will hopefully, at this point, be aware of the importance of reviewing the company's constitution to check whether any optional provision has been disapplied, modified, or supplemented. When considering a dividend, one of the first steps should be to check the company's constitution.

[00:01:25.560] - Suzanne Kearney, Of Counsel

We thought it might be helpful to explain some of the key terminology in relation to dividends, starting with "what is a dividend?" As we've already mentioned, a dividend is a form of distribution and is a payment to the company's shareholders from its distributable profits. Tom, what is the distinction between an interim and final dividend?

[00:01:46.070] - Tom Courtney, Partner

Well, final dividends are traditionally declared at an AGM by the members, the actual dividend being an amount recommended by the directors and based on the prior financial year's results. Interim dividend, on the other hand, are traditionally paid out by the directors in the course of the financial year based on their estimates and opinions as to profitability as derived from management accounts. This is a good example of where a company may have disapplied the optional provisions under the Companies Act. Some companies' constitutions do not distinguish between final and interim dividends, and in many LTDs, this less formal approach will be in keeping with the nature of the shareholders and directors' relationship. Another difference between final and interim dividends is that the former are said to be declared by the members by ordinary resolution at a general meeting where directors, however, pay interim dividends, there is no declaration as such, merely an intention to pay.

[00:02:51.540] - Suzanne Kearney, Of Counsel

Another term frequently used is dividend in specie, or sometimes known as a dividend in kind. While a dividend normally refers to a cash payment to the company's shareholder or shareholders, it is also possible for the payment of a dividend to be satisfied by the transfer of a non-cash asset. Section 125 of the Companies Act permits dividends to be paid in this manner with the approval of the members declaring a dividend. Again, to echo your point, Tom, this is an optional provision, and some company constitutions provides the board can pay a dividend in specie, while others may not permit them at all. So again, it is always important to check the constitution.

[00:03:28.850] - Tom Courtney, Partner

One aspect common to all dividends is the requirement for distributable reserves or distributable profits. As we've already mentioned, a company may only pay a dividend out of its profits which are available for distribution. This is a fundamental rule of law which is enshrined in Section 117 of the Act, which cannot be disapplied or modified by the company in its constitution. A company's profits available for distribution are its accumulated realising profits so far as not previously utilised by distribution or capitalisation, less its accumulated realised losses so far as not previously written off in a reduction or reorganisation of capital duly made. The central rationale is that the only assets a company can distribute are those assets which, in the case of an individual, very roughly accord with his or her disposable income. Any dividend paid made where there are insufficient distributable profits will in fact be unlawful.

[00:04:35.020] - Suzanne Kearney, Of Counsel

So how does a company determine whether or not it has sufficient distributional profits available for distribution, and accordingly, whether it can pay a dividend without contravening Section 117? Whether a company has sufficient profits for distribution is determined by reference to relevant financial statements. Relevant financial statements are the company's last statutory financial statements. However, interim financial statements, generally referred to as management accounts, may be used to bridge the gap between the present and the last set of statutory financial statements. Interim financial statements alone can be used where a company proposes a dividend in its first year of trading when no financial statements have yet been prepared.

[00:05:17.690] - Tom Courtney, Partner

Finally, it is important to note that Section 117 of the Act governs the payment by a company to a member of that company, or in some cases to that member's nominee. The payment by a company to a person which is not a member of the company, whether directly or indirectly, will not require to be made from distributable profits. An example here might be the payment by a company of a lawful debt.

[00:05:44.370] - Suzanne Kearney, Of Counsel

So Tom, now that we've established the fundamentals of a dividend and who they are paid to, do members of a company have any right to receive dividends at all or on a regular basis?

[00:05:55.510] - Tom Courtney, Partner

Well, Suzanne, even where a company has distribution of profits, there is no general requirement to pay a dividend or to pay dividends on an annual basis. The company's constitution or other contractual agreements, such as, for example, shareholders' agreement, may stipulate requirements in relation to the payment of dividends, which will be subject always to the requirement that there must exist distributable profits. However, otherwise members have no right to be paid dividends, nor is there any requirement on the company to dividend a specific amount of the profits which happen to be available for distribution. However, where a final dividend is declared by the members in general meeting, then the shareholder does have a right to be paid and is entitled to sue the company for arrears of their proportion as a contract debt in the same way as any other ordinary creditor of the company may sue for a debt. By contrast, where the director is determined to pay an interim dividend, they do not, under the optional provisions, actually declare that dividend, and so the directors may rescind the payment of an interim dividend by resolution before the date for payment has arrived.

[00:07:10.750] - Suzanne Kearney, Of Counsel

It is also possible, as you mentioned, Tom, to provide in the constitution or rights attaching to a class of shares for a specific right to a dividend. For example, the constitution may provide that a class of preference shares may be issued to whichever preferential right to a fixed dividend, meaning that the holders of those shares are entitled to a dividend in a fixed amount, usually in priority to ordinary shareholder but again, this is always subject to the company having sufficient distributional profits.

[00:07:39.720] - Tom Courtney, Partner

We have already spoken about the statutory and contractual rules governing dividends and critically, the importance of ensuring that the company has distributional profits. So, Suzanne, what are the consequences of a company paying an unlawful dividend?

[00:07:55.440] - Suzanne Kearney, Of Counsel

The payment of an unlawful dividend has consequences both for the directors of the company and also for the members receiving the dividend. Directors who authorise the payment of a dividend, contrary to

Section 117 of the Act, in other words, where the company does not have sufficient distributional profits, are accountable to the company for such unlawful payments. Where a company makes a distribution to its members in contravention of any provision of the act, and where at the time a member beneficiary knows or has reasonable grounds for believing it to be unlawful, that member is under obligation to repay the unlawful dividend. Where a member who receives an unlawful dividend is a director or other officer of the company, there is a strong presumption that they have reasonable grounds for believing that the dividend is unlawful. Having flagged the serious repercussions for the payment of an unlawful dividend, Tom, to finish up, what would be your top tips in relation to approaching the payment of a potential dividend?

[00:08:51.690] - Tom Courtney, Partner

Well, I think regular listeners will begin to get a sense of theme here, Suzanne. The first thing to check is the constitution and the relevant provisions of the Act which govern the declaration and payment of dividends by the company. Don't ever assume that the rules will be the same from one company to the next. Next, it is important to establish whether the company has sufficient distributable reserves by reference to the relevant financial statements or management accounts. Section 117, as we discussed, sets out the legal test. However, assessing the individual components of this test, such as the realised profits and the realised losses, will require accounting input and analysis, and it is ultimately up to the company and its directors to satisfy themselves as to the existence of distributable reserves, regardless of whether they are paying the dividend as an interim dividend or recommending a payment to shareholders in the context of a final dividend. Finally, it is important to document the steps. The board resolutions, in particular, should document each of these considerations so that there is evidence that the directors considered everything that was relevant.

[00:10:03.630] - Suzanne Kearney, Of Counsel

Thanks, Tom. I think those are very helpful tips to finish up today's episode with. We hope our listeners found today's episode informative and as always, thank you for listening. And goodbye.