

Legal News



Developments regarding dividends paid during the financial year

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Dear clients and business friends

Is it possible to have more than one dividend payment in the course of one year? Article 675 of the Code of Obligations ("CO") states that "dividends can only be paid out of the profit resulting from the balance sheet and from the reserves created for the purpose". The interpretation of this legal stipulation has evolved over time, and in practice more than one dividend payment per year is allowed.

Distinctions must be drawn between the extraordinary dividend, the advance dividend and the interim dividend. The interim dividend is the most controversial. So it is hardly surprising that the Federal Council's plan for the revision of the law relating to limited companies, currently being debated in the federal parliament, contains a proposed new CO article on this type of dividend.

We set out below the current practice regarding dividend distribution during the financial year, together with the new features proposed in the Federal Council's statement of 21 December 2007 in respect of interim dividends.

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1. Extraordinary dividends

The "extraordinary dividend" (not to be confused with the interim dividend, dealt with in section 3 below) is the dividend which an extraordinary general meeting, held after the ordinary general meeting, decides to pay out, additionally or otherwise. For example, an ordinary general meeting approves in May the previous financial year's accounts, together with the payment of a dividend, and then decides two months later, in July, to approve an extraordinary dividend.

The matter of extraordinary dividends is not specifically regulated in Swiss law. However, their payment is permitted provided the conditions for the payment of ordinary dividends are adhered to (CO article 660 et seq.). These conditions are as follows:

- i) That the profit resulting from the balance sheet or freely available reserves allow such payments. To determine whether a company has sufficient freely available equity, one should base oneself on the annual accounts that have been approved by the last ordinary general meeting;
- ii) That the payment of an extraordinary dividend does not cause the company any liquidity problems;
- iii) That an interim balance sheet must be drawn up (and revised if the company is subject to ordinary or restricted auditing), if the financial year's closing date is more than six months prior to the extraordinary general

meeting's decision or if there are grounds for thinking that the company's financial situation has deteriorated since then (article 652d CO by analogy);

iv) That if the company is subject to ordinary or restricted auditing, the auditor must declare without reservations that the board of directors' decision in respect of payment of an extraordinary dividend is compliant with the law and the articles of association;

v) That the proposed payment of an extraordinary dividend must be approved by the general meeting of shareholders.

2. Advance dividends

A company may offer its shareholders an advance dividend paid out of the current year's profit. Legally, this advance is considered to be a loan, which will be repaid in a compensatory manner by the dividend decided by the general meeting of shareholders when the annual accounts are closed. In this case, the auditors must produce a report stating what payments on account have occurred during the financial year.

If no dividend is paid or if it is lower than the amount of the advance, the board of directors must then undertake a reduction of capital or apply to the shareholders to obtain restitution or an acknowledgment of debt, accompanied by a payment plan and, if possible, by guarantees. It is essential that the company ensures ahead of any advance

that shareholders are solvent and that they are of sufficiently limited number that repayment of the advance remains possible. Moreover, the board of directors must avoid making too large an advance, in such a way that the general meeting of shareholders retains sufficient room for manoeuvre in respect of fixing the amount of the dividends. Whatever happens, the solution adopted must respect the principles of equal treatment of the shareholders and good faith.

3. Interim dividend

The interim dividend is peculiar in the sense that it is paid out of the profit derived from the current year. The payment of this type of dividend was until recently considered to infringe Swiss law. Today, authors such as Böckli and Forstmoser concede that the payment of an interim dividend is possible provided the conditions for the distribution of an ordinary dividend (see section 1) are fulfilled. However, unlike the payment of an ordinary or extraordinary dividend, payment of an interim dividend requires that an audited interim balance sheet be drawn up, if the company is subject to obligatory auditing.

When these conditions are fulfilled, the rules for the protection of share capital are considered to have been fulfilled, and therefore the payment of an interim dividend is permissible. If not, the payment will be considered to be an advance dividend.

The question of interim dividends has been examined pragmatically by the federal tax authorities who now tax the payment of these dividends in the same way as ordinary dividends in terms of withholding tax.

The position of auditors has also evolved, which should be reflected in the next edition of the Swiss Audit Manual, expected at the end of this year or the beginning of 2009.

4. Proposed new law

The Federal Council has proposed a new article of the Code of Obligations, article 675a CO, according to which a general meeting of shareholders can decide to pay an interim dividend when the articles of association so provide and an interim balance sheet for the preceding six months has been drawn up (paragraph 1). The balance sheet must be checked before the decision of the general meeting of shareholders if the company is subject to compulsory auditing (paragraph 2), e.g. if the company has not opted out.

Finally, paragraph 3 provides for the distribution of the dividend to be governed by the same rules as that of the annual dividend.

5. Sanctions

Violation of the rules limiting distribution of dividends in principle nullifies the decision of the general meeting of shareholders, while violation of the formal dispositions (such as the drawing up of an audited interim balance sheet and the approval of the auditors) is in principle subject to defeasibility. Dividends paid in undue manner may be claimed back by the company under certain conditions. Finally, it should also be noted that the board of directors and/or the auditors may be held civilly or criminally responsible in the event of a serious violation.

6. Conclusion

The interim dividend, considered illegal by some until a few years ago, has recently undergone a certain evolution. The proposed revision of the law of limited companies expressly provides for the payment of interim dividends under certain conditions. This evolution is to be welcomed, since it answers the needs of company practice, while respecting the precepts of company law on the protection of capital.

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