Family companies and the many tax traps

If you own a family company, then it is very important how you receive and treat any payments made from the company to you (or your associates – for example, your spouse). And this is simply because any payment from a company (other than a return of the original capital) is, in most cases, prima-facie a dividend in the hands of the recipient – however it may otherwise be classified.

In particular, if you arrange for your company to provide you (or your associate) a loan, then it will be deemed to be a taxable dividend (and an unfranked one at that) – unless you comply with the requirements for it to be a "complying loan" (which includes imposing a market rate of interest on it). Likewise, any forgiveness by the company of the loan made to you will be treated as a deemed dividend in your hands also – again unless certain requirements are met.

This area of treating loans by the company to a shareholder (or associate) as a deemed "Div 7A dividend" is a fundamental issue in tax law – and has been for many, many years.

And it is a matter that you should always speak to your adviser about.

Importantly, it also extends to the case where your family trust makes a resolution to distribute trust income to a beneficiary company (usually a so-called "bucket company") and the amount is never actually paid to the company but is kept in the trust.

In this case, the ATO treats this as a deemed dividend made by the company to the trust – albeit, it is a hot button issue in tax at the moment as to whether the ATO is correct in its approach to this.

Again, this is a matter that you MUST always speak to your adviser about – especially with the current uncertainty and changes in the air in relation to Div 7A.

With family companies there is also the issue of loans made by shareholders or directors to the company and any subsequent forgiveness of them.

On the face of it a complete forgiveness of the debt owed without any repayment of the loan should trigger a capital loss in the hands of the shareholder or director.

However, the tax laws are more sophisticated than this – and a capital loss will only arise to the extent that the debt is incapable of being repaid by the company. There is also an argument as to whether any capital loss should be available at all even if the company could not repay the debt.

Likewise, there will be consequences for the company.

While no immediate taxable gain will arise to the company from the release of its obligation to repay the debt, there may be a restriction on its ability to claim tax deductions in the future for such things as carry forward tax losses and/or depreciation. While this may not be an issue if the company is winding up, it will be if it continues to operate.

So, the moral of the story is just because you own the company doesn't mean you can treat it as your own private bank to make withdrawals from it as you please or make loans to it (and forgive them) – without considering the serious tax consequences of such actions.

There will always be tax consequences – and you will always need professional advice on this matter. ■