

Changes to Qualifying Company/ Loss Attributing Qualifying Rules

November 2010

Draft legislation for the reform of qualifying companies (QC) and loss attributing qualifying companies (LAQC) has just been released. Now is the time to consider the implications of these changes for you.

What is changing?

The Government will effectively abolish the LAQC rules for the income year starting on or after 1 April 2011. If no action is taken LAQCs will become QCs by default; QCs have the same characteristics as LAQCs but without the ability to attribute losses to shareholders.

A new type of tax entity is to be introduced called a 'look through company' (LTC). A LTC will be treated like a partnership for tax purposes with all income, expenses, tax credits gains and losses allocated to shareholders (subject to loss limitation provisions). The income and loss pass-through calculations based on the current draft legislation, is not always straight forward. A LTC will provide the benefits of a corporate structure in terms of limited liability but with the tax characteristics of direct ownership.

Transitional rules

A transitional period will be made available for shareholders of an existing QC / LAQC to elect to transition into a new structure without incurring any tax costs. This provides us with a one off planning opportunity to alter the current structure without tax cost, and in some situations results in some permanent tax savings.

A QC / LAQC will be able to choose to:

- continue to be a QC (without loss attribution)
- become:
 - an LTC
 - a partnership
 - a limited partnership
 - an ordinary company
 - a sole trader.

Once the transitional period has expired any change in ownership structure may create a tax event which could result in an unfavourable tax position, such as triggering depreciation recovery or forfeiting accumulated losses.

The Government has noted that it intends to retain the QC regime while a review of the dividend rules for closely held companies is carried out. Once this review has been completed there may be further changes.

The table overleaf summarises the entities noted above (with effect from 1 April 2011).



	QC	LTC	Limited partnership	Ordinary company	Sole trader
Tax rate on income	28%	Shareholders marginal rate	Partners marginal rate	28%	Marginal rate
Losses - flow through	x	Yes - subject to limitation	Yes - subject to limitation	x	✓
Nature of ownership (for tax purposes)	Shares	Underlying assets	Underlying assets	Shares	Underlying assets
Tax free access to capital gains	✓	✓	✓	On liquidation only	✓
Participation in management	✓	✓	General partners only	✓	✓
Restrictive eligibility criteria	✓	✓	✓	x	x

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Issues to consider

When reviewing your situation there are a number of issues to consider, including:

- Current and future expected profits and / or losses
- The extent of other income to offset losses against
- Accessing capital gains
- Applicable tax rates
- Asset protection
- The value of assets; particularly property and the extent of depreciation claimed
- Number of properties held
- Plans for acquiring property or selling property
- Debt levels
- Conflicting needs of different shareholders
- related entities and the nature of their operations

This is not an exhaustive list and when seeking to determine the most appropriate entity type it will be a matter of finding the right balance between what may often be competing factors.

Next steps

We encourage you to begin reviewing your position now and contact us to assist with this review to determine what type of entity will be most suitable for you. Once we have determined the most appropriate entity it will be important to file the necessary elections (where required) within the transitional period to avoid any adverse tax

consequences.

Alongside any change in structure may also be the need for the transfer of shares, assignments of debt and the like. As part of our review process we can identify where this will be needed and ensure the required work is completed.

To ensure enough time to evaluate your situation and carry out any additional work required please contact us by 21 February 2011 if you would like us to undertake a review.

Note

Note the points above are general in nature and the appropriate steps to take and applicable rules may vary depending on the specific situation.

The new rules and changes noted above are based on proposals released by Government which are still at draft stage and therefore subject to change. Whilst there may be changes the expectation is that further amendments will be of a minor nature.

