

Loss Attributing Qualifying Company Reforms

Proposed Changes

IRD has provided the draft legislation released regarding the proposed changes to the Qualifying Company (QC) and Loss Attributing Qualifying Company as below;

A new "look through company" (LTC) to be treated similar to partnership for tax purposes however it remains a company for commercial purposes. The LTC is the new LAQC with changes such as attribution of income as well as losses and losses being subject to loss limitation rules.

The mechanics of the proposed new legislation is not straight forward regarding shareholders receiving the same entitlement to losses as partnership or as a sole trader. Existing QCs & LAQC's will not become LTCs. They will have to elect into the regime within 6 months from the start of 2012 income. When electing under this period they will be electing under transitional rules which will preclude having to pay tax on the existing reserves of the company on election.

Exiting QCs/LAQC's will be able to elect to be an LTC, a limited partnership, a partnership a sole trader without any further cost, if it is done so within 6 months from the commencement of 2012 year. This provides clients opportunity to consider which entity they will proceed with.

If clients decide to wait to restructure, there will be additional tax costs associated with disposal of assets and on existing reserves if electing to become an LTC other than under the transitional provisions.

If existing clients with QCs and LAQC's do nothing they are able to stay in the QC regime but with no ability to attribute losses to shareholders. The government has advised that a review of the current dividend rules for QCs will be undertaken.

Criteria for LTC

- Cannot be a unit trust, listed limited partnership for foreign corporate limited partnership
- NZ resident company (and not non resident under DTA)
- Each Shareholder or "owner" in the LTC can be either individuals or trusts
- LTC must have five or fewer look-through counted owners
- LTC must only have one class of shares with same rights
- All owners must elect for an eligible company to become LTC
- LTC files tax returns
- Loss limitation rules apply
- Rules apply to disposal of look through interest
- No limit on interests a LTC can hold in FIF's or CFC's or foreign sourced non-dividend amounts
- Company must meet eligibility criteria for the whole income year.

Formula for Distribution of Loss

- Investments – Distributions + income – deductions – disallowed amount
- Investments = Equity, loans to company, guarantees to company (including banks)
- Distribution = Dividends, capital & reduction in any guarantees
- Income = Revenue Generated
- Deductions = Allowable expenditure
- Disallowed Amount = up to \$10,000, Putting up Capital into company at balance date & taking out within 60 days of balance date

Loss Limitation Rules

- LTC loss limitation rules do not affect owners claim to brought forward losses, losses unable to be utilized are carried forward.
- When electing to become a LTC/partnership or limited partnership/sole trader during the transitional period they will be:
 - No tax on revenue reserves
 - No tax cost on changing to a partnership, limited partnership or sole trader
 - Losses b/f will be eligible for offset against future income from the replacement entity
- However company's electing to become a LTC after the transitional year will have their losses forfeited and will be taxed income based on proportion of owner's share of untaxed revenue reverses.
- Company's ceasing to LTC status will be taxed as an ordinary company, there is deemed disposal of assets at their market rate. Dividends paid in subsequent years are assumed to be first from retained revenue profit of the LTC and to that extend are exempt income.

Next Course of Action

- When deciding which entity type to use, we suggest you contact Success Group to discuss important aspects.
- Business entity structure most suitable – industry the client will be working, and whether it will be risky
- Loss flow through – will limitation rules, render losses less valuable
- Distribution of capital gains in the future, are these required without liquidation?
- Commercial Issues (contracts, financing issues etc)
Will new investors be introduced later on?
- Relationship property planning
- Costs
- Tax Avoidance
- Marginal tax rate: which is best, will the company be able to maintain LTC status
- Restructure business to maximize the membership basis – test for calculating losses utilizable by owners.

We suggest you contact our Office before deciding which structure to use and liaise with us to review your individual tax position to achieve the best tax position.