



QC / LAQC Changes

You Need to do Something NOW!!

For income years starting on or after 1 April 2011, LAQC's will no longer be able to attribute losses to shareholders. All LAQC's will become QC's unless they elect to change to another business structure.

This Newsletter provides a brief summary of the changes and lists the issues you need to consider in deciding what ongoing structure you want to trade as.

The Newsletter is based on our initial understanding of the legislation. We expect fish hooks to emerge as the legislation gets better understood. For this reason we will delay any detailed review/recommendation until early March.

Summary of Changes

1. LAQC's cease to exist.
 2. LAQC becomes a QC unless taxpayer elects for it to become either:
 - a) a Look Through Company (LTC);
 - b) Partnership (including a Limited Partnership)
 - c) a sole Trader (if only 1 shareholder).
- If you expect to have ongoing losses and want to offset these against other income you will have to elect one of a), b) or c).
3. You have 2 years from 1 April 2011 to elect to transfer to a new structure with **NO TAX COST**.
 4. For the election to be valid from 1 April 2011 the election must be made by 30 September 2011.
 5. Ownership of the LTC or partnership must be identical to ownership of the LAQC.
 6. All of the LAQC's assets, liabilities, tax balances and other obligations automatically transfer to the new entity with no tax cost. There may however be other costs e.g. solicitors and bank fees.
 7. You cannot transfer to an ordinary (non QC) company with no tax cost.
 8. The QC regime will continue until the government reviews the law relating to the taxation of company distributions.

QCs can however, transfer to a new entity tax free if they want. If your company is a QC only we will not carry out a review unless you request us to do so.
 9. All legal work to transfer assets and liabilities must be completed by 31 March 2012 if you elect to transfer to a new structure effective from 1 April 2011. Failure to do so will mean adverse tax consequences as you will be taxed as an ordinary company, which may result in having to pay tax on assets transferred.

It will therefore be crucial that your solicitor gets all the legal work done in time.
 10. If you initially decide to become a QC you can still elect to move to a new structure in Year 2 at no tax cost.

What is a Look Through Company (LTC)?

The main features are:

- A LTC must have five or fewer owners (the ownership interest of relatives are combined).
- All owners must elect for the LTC rules to apply initially.
- Once a company becomes an LTC it will remain so unless one of the owners decides to revoke the LTC election, or the company ceases to be eligible.
- Only a natural person, trustee or another LTC may hold shares in an LTC. All the company's shares must be of the same class and provide the same rights and obligations to each shareholder.
- An LTC's income, expenses, tax credits, rebates, gains and losses are passed on to its owners. These items will generally be allocated to owners in proportion to the number of shares they have in the LTC.
- Any profit is taxed at the owner's marginal tax rate. The owner can use any losses against their other income, subject to the loss limitation rule.

- The loss limitation rule ensures that the losses claimed reflect the level of owners' economic loss in the LTC. Owners' excess losses are carried forward to future income years, subject to the application of the loss limitation rule in those years.
- When owners sell their shares they are treated as disposing of their share of the underlying LTC property. Exiting owners are generally required to account for tax on disposing of their shares in the LTC only if the amount of the disposal proceeds derived from their LTC interest exceeds the total net tax book value of their share of LTC property by more than \$50,000.
- Even if this \$50,000 threshold is exceeded, exiting owners will not have to account for tax on things such as trading stock in certain circumstances.
- The disposal thresholds do not apply if the company is liquidated, or ceases to use the LTC rules but otherwise continues in business. In these situations, the owner is deemed to have disposed of their shares at market value on the date of exit.
- Look-through treatment applies for income tax purposes only. An LTC retains its corporate obligations and benefits, such as limited liability, under general company law.
- An LTC is still recognised separately from its shareholders for certain other tax purposes, including GST, PAYE and certain administrative or other withholding tax purposes under the Income Tax Act.
- The LTC must be tax resident in NZ.
- An ordinary company cannot hold shares in a LTC.
- **N.B.** If a LTC breaches the eligibility criteria its LTC status is lost from the start of the year of breach. It then cannot be a LTC in that year or either of the 2 following years i.e. LTC status is lost for 3 years.

LTC Losses

The amount of loss that can be claimed is limited to the shareholders "investment" in the company. "Investment" includes a share of any guaranteed bank debt.

The level of "investment" will have to be calculated each year which will add further cost.

Shareholders who have not personally guaranteed bank loans may be unable to offset losses against non LTC income as many shareholders with overdrawn Current Accounts

The 5 or Fewer Owners Test

The calculation can be complex especially where Trusts are shareholders. Once again this will increase the cost of being a LTC.

Issues to Consider

1. Will your company have ongoing losses?
2. Can you utilise those losses against other income?
3. If the company's only asset is rental property are you likely to sell the property in the near future?
4. Is your level of "investment" in the LTC such that you will be able to claim the loss?
5. Are you prepared to pay the annual cost of calculating the level of "investment" for each shareholder and of monitoring the 5 or fewer test?
6. Will trading as a partnership or Sole Trader create any possible risks for you?
7. If the LTC makes a profit will you end up paying more tax than if you were an Ordinary company?
8. What will the effect on ACC levies be? They may be significantly higher than an Ordinary company.
9. Is there any risk of 1 shareholder refusing to sign the LTC election or subsequently revoking it?
10. Will any subsequent sale of shares in the LTC create any tax issues - may do if gain exceeds \$50,000 - unfortunately once again the issue is complex.

Our Thoughts on LTC

Although, at a quick glance it could be assumed a LTC is a LAQC in another guise, this is not correct.

The issues surrounding a LTC are more complex and annual costs will be higher.

Our initial thought is to avoid becoming a LTC if at all possible. Having said that there will be some LAQC's which, because of the level of losses and potential personal liability, may have to become LTC's - although even in this case a Limited Partnership may be a better bet.

What Next?

Once we (and others) have had a chance to better understand the LTC legislation (a number of seminars are being run in February which we will attend) we will, for those clients who authorise us, review your situation and come back to you with a recommendation.

The cost of this review and recommendation is difficult to determine at this stage and will obviously depend on the nature of your business assets held, shareholding, future intentions etc, etc. However we would expect it to be in the range of \$350 (for relatively simple situations) to \$800 (for complex structures).

If you want us to do the review on your behalf please sign the authority below, and return ASAP.

Provided we receive your authority (below) by 20 February 2011 we will report back to you by 31 March 2011.

If we do not receive your written authority we will assume you will make the decision as to the most appropriate structure. In this case Winstanley Kerridge Ltd will have no liability for any adverse tax/legal consequences. You will need to advise us of the new structure so that we can update our records.

Confidential

The information contained in the Newsletter is issued in summary form exclusively for the information of clients and staff of Winstanley Kerridge Ltd and should not be used or relied upon as a substitute for detailed advice or as a basis of formulating business decisions.



(Please detach and return to Winstanley Kerridge Ltd)

To Winstanley Kerridge Ltd

..... Limited
(insert company name)

either

I hereby authorise you to undertake a review of and give a recommendation as to the most appropriate structure for future ownership of the company.

..... DirectorDate

or

I will make my own assessment of the most appropriate structure and will advise you accordingly. In this case I understand Winstanley Kerridge Ltd has no responsibility/liability for any adverse tax consequences.

N.B. *If you have, since 31 March 2010, sold any major asset or intend to do so in the near future, please note here:*

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Please sign and return for our records.