Horton&Co Ltd

chartered accountants

Qualifying Company & Loss Attributed Qualifying Company – Rules are changing.

In December 2010 legislation passed that made important changes to the rules of Qualifying companies (QCs) and Loss Attributed Qualifying Companies (LAQCs). These changes mean that LAQCs will no longer be able to attribute losses to shareholders, which effectively means LAQC's have been abolished.

These changes will take effect from 1st April 2011.

There are several options to consider:

- Remain as a QC
- Revoke QC status and become an ordinary company
- Transfer assets to sole trader
- Transfer assets to partnership
- Transfer assets to limited partnership
- Become a look-through company (LTC)

Remain a QC:

Advantages:

- Limited Liability
- Capital gains paid to shareholders
- Non-fully imputed dividends exempt from tax
- Profits taxed at 28%

Disadvantages:

- Losses will accumulate in the company
- Future of QC's is uncertain

Revoke QC status and become an ordinary company:

Advantages:

- Limited Liability
- Profits taxed at 27%

Disadvantages:

- Non-associated person capital gains will only be accessed on wind up of the company
- Accumulate losses in the company

Transferring assets to sole trader or limited partnership:

Advantages:

- Transition at no tax cost
- Capital gains accessed tax free
- FBT Issues eliminated
- Profits taxed at personal tax rates
- No restriction access to losses
- Lower compliance costs

Disadvantages:

- For sole traders, wages paid to spouse require IRD approval
- Loss of limited liability
- For partnerships, salaries paid to working partners only deductible if there is an employment contract
- Re-imaging with clients

Transferring assets to limited partnership:

Advantages:

- Limited liability
- Profits taxed at personal tax rates
- Transition at no tax cost
- Capital gains accessed tax-free

Disadvantages:

- Use of losses may be restricted
- Salaries paid to working partners only deductible if there is a contract
- Higher compliance costs
- Re-imaging to client

Look-through company (LTC):

There has been an introduction of a new look-through company tax entity for closely-held companies in place of a LAQC. LTCs retains its identity as a registered company.

To be an LTC:

- The company must be a New Zealand tax resident.
- The shareholders must be either individuals/ trusts or another LTC.
- Must have 5 or fewer shareholders.
- Must have only 1 class of shares
- All income, expenses, tax credits, rebates, gains & losses passed onto its shareholders in accordance with their effective interest in the company.
- On a breach of eligibility or a shareholder revocation the company is taxed as an ordinary company.

Advantages of LTC:

- Limited liability
- Profits taxed at personal tax rates
- Access to losses (subject to the limitation rule)
- Can transition from QC/ LAQC at no tax cost
- No effective change to structure

Disadvantages of LTC:

- Ensurance that eligibility is maintained
- Salaries paid to working shareholders only deductible if there is an employment contract.
- FBT issues for working shareholders remain.
- Changes in shareholding can trigger tax consequences.

In addition, QC/ LAQC **cannot** choose to transition into a trust. Trustees should then consider whether QC/LAQC shares they own should be distributed to beneficiaries before 31st March 2011.

The following information is to give you a general outline. For more detailed information that is tailored to your business's needs you will need to contact us on **06 758 7562 or 0800 HORTON (467 866).**