

## Important LAQC alert: The legislation is now final

On 20 December 2010, legislation was enacted to effectively remove the attribution of losses for all LAQCs (Loss Attributing Qualifying Companies), with effect from 1 April 2011 (The exception being for early balance dates, for which the effects are delayed until the 2012/2013 year).

The Government's overriding strategy behind the introduction of flow-through treatment of profit and losses is to prevent what they refer to as 'arbitrage' - the retention of profits in a company, therefore utilising a lower company tax rate (28% as of 1 April this year).

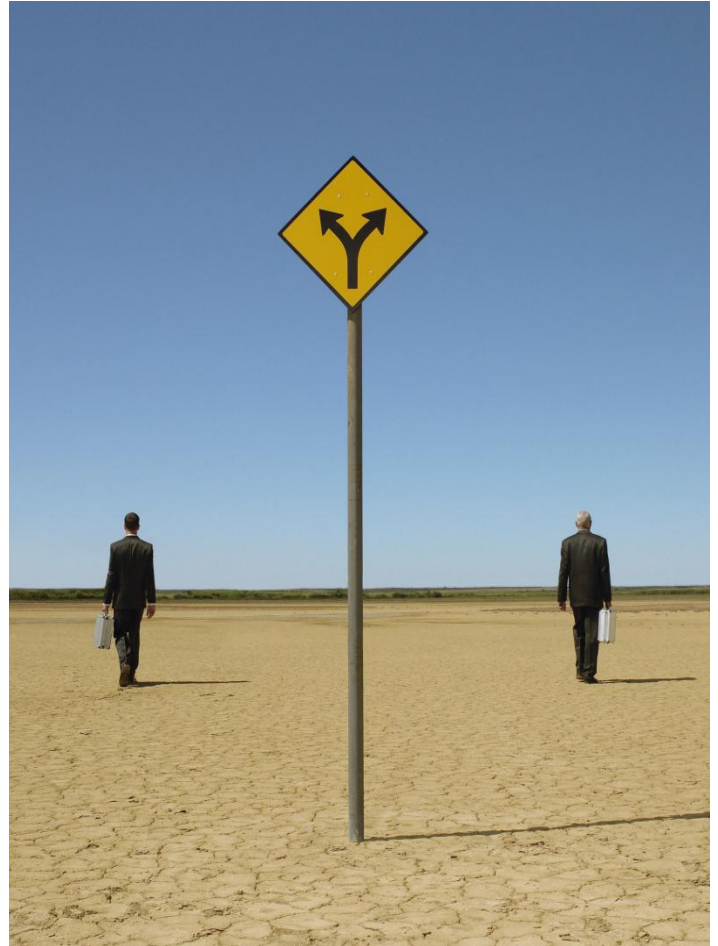
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### Summary of Changes and Implications

The following is a brief summary of the most significant changes and implications:

1. As of 1 April 2011, LAQCs will not be able to attribute losses to shareholders.
2. A new tax entity, called a Look Through Company (LTC) is now created. Profits and losses (but with some limitations) are passed on to its shareholders. This means that profits and losses will be deducted or taxed at the shareholders' marginal tax rate.
3. Losses in LTCs will only flow through to its shareholders to the extent of the shareholders' investment in the company (including the share of any debt guaranteed by that shareholder).
4. The shareholders of an LTC will be treated as holding the assets of that LTC directly. If they sell their shares in an LTC they will therefore be treated as disposing of their interest in the underlying company property (subject to some exceptions) and will therefore be up for any associated tax consequences. Examples are depreciation recovered and gains on the sale of trading stock.
5. If the company exits the LTC regime (which could happen unintentionally) a disposal of the company assets will be deemed to have happened and this will possibly give rise to negative tax consequences.
6. LTCs will not pay income tax as all income will be attributed to shareholders and those shareholders will be responsible for their own tax.
7. LTCs can only have one class of shares.
8. Having said all that, the above is merely a tax fiction. An LTC retains its identity as a registered company with limited liability and therefore is still governed by the Companies Act 1993.

The above list is not an exhaustive one. The legislation is complex and as you can probably read between the lines, it's not as simple as simply transferring all of our LAQC clients across to the LTC regime. In fact LTC status may create real tax disadvantages for a number of our clients.



## Broad Options

Very broadly, clients will have several options available to them. These are:

1. Become a LTC (Look Through Company).
2. Remain as a QC (Qualifying Company), but without the ability to attribute losses to shareholders.
3. Exit the QC regime and effectively become a standard company.
4. Restructure the ownership of their business/assets so they are owned by a Partnership, a Limited Partnership or a Sole Trader.



## Transition from LAQC to Another Entity

1. Transitional rules with tax concessions have been introduced to enable us to transition you across to an LTC, a Partnership, a Limited Partnership or a Sole Trader.
2. While the transitional rules allow us until 30 September 2012 to elect to become an LTC or transition to another entity type, it is important that we review every LAQC (except for those with early balance dates) prior to 31 March 2011 as we may need to alter shareholdings in some LAQCs, as well as put firm tax and therefore dividend plans in place prior to then.
3. We will need to file election documentation with IRD for all LAQCs that need to become LTCs, as well as give written notice to IRD for any LAQCs that choose to transition to another entity type, such as a Partnership.
4. For those LAQCs that need to transition to another entity type rather than become an LTC, there will be administrative tasks and potentially restructuring and legal costs and associated issues. These include:
  - Ensuring that all current finance terms are not adversely affected
  - Transferring commercial contracts and banking arrangements to the new entity
  - The legal transfer of businesses/assets to the new entity with its associated legal costs
  - The transfer of employment agreements across to the new entity
  - Potentially a raft of Inland Revenue registrations and de-registrations
  - Transfer of all insurance covers
  - Informing suppliers of the new entity so that you hold valid tax invoices
  - Deciding whether the LAQC should be liquidated, or registered as a non-active company, or left as a shell company

## Next Steps

1. We're undertaking a review of all of our LAQC clients. We expect that review to be completed by 31 March 2011. Naturally there will be a cost associated with that review.
2. Once we've completed your review, we'll send you our written recommendations:
  - If your situation is relatively simple, we'll ask that you send your acceptance of those recommendations. Once you've done that, we'll complete the necessary paperwork as well as advise you of any administrative tasks you need to take care of.
  - If our recommendations are more complex in nature (for example, we recommend you transition your LAQC to another entity) its likely we'll need to meet and discuss all of the implications of that transition.

So, with all of the above in mind, please sign our LAQC review approval letter and in the meantime don't hesitate to phone or email us with any questions or ideas.

Our overriding aim here is to give you the best possible tax advice, not just for the present, but for the future.

**"It isn't so much that hard times are coming - the change observed is mostly soft times going."**

**Groucho Marx**

### Disclaimer

This publication has been carefully prepared, but it has been written in the general terms only. The publication should not be relied upon to provide specific information without also obtaining appropriate professional advice after detailed examination of your particular situation.

