



Special LAQC Alert: the jury is out

Death of the LAQC as we know it

You will have to make some decisions as LAQC's as we know them, will cease to exist. In addition, any advice that we can give to you will depend on information such as your plans over the next few years, any guarantees existing on bank loans, as well as any anticipated changes to shareholders' earnings.

In order for us to properly research and establish the best option for you, we ask that you go through the information and then answer a few questions on the attached sheet.

Please return this via fax/email back to us. On receipt of this information and your signed authority to proceed, we will go ahead with the review of your situation and advise you accordingly. We may also invite you to a meeting at our offices if necessary, where we can outline what options are available and how best to proceed.

It is necessary that some changes may need to be put in place before 31st March, and so we request that these questionnaires are returned to us as soon as possible so that we can proceed with assessing your situation.

We look forward to receiving your information at the earliest opportunity.

In May 2010 the Government announced the introduction of flow-through treatment of profits and losses for closely held companies. Government is keen to implement measures that prevent what is sometimes referred to as 'Arbitrage', i.e., the retaining of profits in a company and therefore the utilisation of a company tax rate (28% as of 1 April next year) that is lower than the top personal rate (33% as of the same date).

Their proposals attracted a number of submissions from business and professional groups, including the NZ Institute of Chartered Accountants. Those submissions have had some impact on the original proposals.

Inland Revenue's policy division has now prepared draft legislation to implement the far reaching changes to the Qualifying Company regime. Although the legislation is still in a draft form, it is likely to become final within weeks.

A general overview of the changes and implications

1. As of 1 April 2011, LAQCs will not be allowed to attribute losses to shareholders.
2. The legislation creates a new entity, called a 'look through Company' (LTC).
3. Companies will be allowed to transition across to become an ITC, or alternatively they can change to another business structure (for example a partnership), without any tax cost.
4. An LTC's profits and losses will be passed on to its owners, according to each shareholder's effective interest in the company. This means that losses and profits will be deducted or taxed at the owner's marginal tax rate.

5. Losses in LTC's will only flow through to owners to the extent that those losses reflect their economic loss. (Getting complicated now)
6. Owners must elect to become an LTC. In other words, we as your accountants will need to complete precise IRD forms to ensure an LTC election is valid.
7. The shareholders of an LTC re will be treated as holding the assets of that LTC directly. This raises complex issues where those assets are sold.
8. Remember, this is all a tax fiction only - an LTC retains its identity as a registered company and therefore is still governed by The Companies Act.

We must at this point stress the very general nature of the above overview. The legislation is quite complicated and we know you don't appreciate wordy and complex epistles on tax. It's our job to cut through all of that for you.

For those clients with LAQCs, what are the options?

1. Stay as a Qualifying Company (QC). This means you will not be able to allocate any company losses to shareholders. Losses will need to be used by the company, against other income. If your company makes regular losses, and you want to use those losses against personal income (such as profits from another business, or wages from employment), this option may not work best for you.
2. Be taxed as an ordinary company. Once again, you will not be able to allocate company losses to shareholders. Also, you will miss out on certain other benefits that QCs enjoy, such as the ability to distribute capital gains without winding up the company.
3. Be taxed as a Look Through Company (LTC), as summarised above.
4. Restructure to another type of entity, such as a partnership, a limited partnership, or a sole trader. As you can imagine, such a restructure is not necessarily a simple matter.

Your company and the way forward

We have to stress at this very early point that the legislation is still in its draft form. In fact, there are one or two key aspects of the legislation that are yet to be written. By way of example, the Inland Revenue election forms have not yet been designed.

As accountants, we need to educate ourselves before we can advise you. And so, over the coming weeks we'll be doing just that.

We'll talk individually to all of our active LAQC clients, and we're hopeful that we'll be able to provide you with what we believe is likely to be the best option for you.

The transition across to an LTC or the restructuring for those clients for whom the company vehicle is no longer appropriate, will be completed in the first quarter of 2011.

As the old Arab saying goes ... **'The dogs may bark, but the caravan moves on.'**



Ensuring your future is clear!

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Additional Information from clients re LAQC changes from 01/04/2011- Questionnaire

LAQC name:

Do you intend selling any rental properties?

Address:When:

.....

Address:When:

Are there any 3rd parties (non shareholders) as bank loan guarantors?

Do you intend to purchase any more rental properties?

Anticipated changes in personal earnings?

Name: Anticipated change

Name: Anticipated change

Additional information regarding:

Changes to rental activity over next few years:

Continued residency in NZ:

Other information:

Authority to proceed with assessment of LAQC: YES / NO

(Please circle Yes if you wish us to proceed or No if you do not)

Shareholder Name:•.....

Signature:•.....

Please send back to us: Fax 09 273 3680 or email to admin@monteckgroup.co.nz



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