

OUT WITH THE OLD - IN WITH THE NEW

Of all the Budget tax announcements the one we received the most feedback on was LAQC's.

In *Tax Assessment* October 2006 we warned that Inland Revenue had loss attributing qualifying companies in its sights.

In the Budget Finance Minister Bill English announced that LAQC's will be treated like limited partnerships from 1 April 2011, meaning QC income will go into the shareholders tax returns and a loss limitation rule will apply to losses.

The detail of the announcement was released after 5 on Budget night and the devil sure is in it.

From 1 April 2011:

1. LAQC's and QC's as we know them will go
2. existing LAQC's and QC's will become a flow-through entity called a QC

3. all income of the QC will be taxable to the shareholders in proportion to their interest in the QC
4. losses of the QC will be deductible to the shareholders in proportion to their interest in the QC; but
5. the loss deduction will be limited to the shareholders economic interest in the QC ("the loss limitation rule")
6. QC's will be defined and treated as a partnership for tax purposes rather than a company meaning:

- profits, capital gains, interest received, dividends received, expenses etc will have to be distributed proportionately to all shareholders
- private use adjustments will apply
- working shareholders will have to have an employment contract and be in the PAYE system for "shareholder-employee salaries" to be deductible
- shareholders will be personally liable for tax on remitted debts
- if a company ceases to be a QC there will be deemed disposals of assets at market value with the shareholders facing depreciation

June 2010

recovery, tax on gains from trading stock and possibly land

- the ceased QC will be deemed to acquire the assets at market value
- if a QC is liquidated there will be a disposal with tax consequences to the shareholders and if the assets are taken over *in specie* there will be a deemed acquisition at market value
- no imputation credit accounts will be required as all dividends will be tax-exempt
- no limitation on foreign sourced income
- all QC's will be only allowed to have one class of share
- the QC will file an IR 7 Partnership tax return
- it appears (although the detail is unclear on this point) that trustees will be required to return QC income (taxed at 33%) rather than the current requirement to pass dividends through to a beneficiary.

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LAQC'S/QC'S

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Losses

The use of QC losses by shareholders will be subject to a loss limitation rule.

Shareholders will only be permitted a deduction for losses to the extent of their investment in the QC.

This is similar to the rule applying the limited partnerships. What is unclear is whether or not the value of personal guarantees will be able to be taken into account in calculating the extent of a shareholders investment.

The value of guarantees are taken into account when calculating the level of investment in a limited partnership.

A shareholder in a QC will usually have made loans to the QC and guaranteed debt. The consultation document is silent on this point.

We would expect however that the value of guarantees will be taken into account.

Unutilized losses will be carried forward by the shareholder.

So what do we think?

For property investors (or those that remain) the QC has probably had its day. We would be inclined to look at individual/partnership ownership of property investments or if the long term view is taken - trust ownership.

For small business - we love it!

The new QC:

1. is simpler to establish than a limited partnership
2. has all the advantages of partnership
3. has all the advantage of limited liability (except for income tax debt).

The proposal forces QC's back to what they were originally intended for.

Budget 2010

Other tax reform contained within Budget 2010 includes:

- personal income tax cuts from 1 October 2010
- Increase in the rate of GST to 15% from 1 October 2010
- the top tax rate for portfolio investment entities (PIEs) reduces to 28% from 1 October 2010
- company tax rate will decrease from 30% to 28% for the 2012 income year with consequential reduction in imputation ratio to 28/72 and a 2-year transition as there was when the rate dropped from 33% to 30%
- from 1 April 2011 investment losses will be added back to taxable income for the purpose of determining eligibility for Working for Families (WFF) assistance with further changes covering areas such as trusts and income from cash PIEs to follow
- the 20% depreciation loading for new assets was removed from budget day
- depreciation of buildings with expected lives of 50 years or more will be set to zero from the 2012 income year
- transactions between GST registered persons involving land will be zero-rated from 1 April 2011
- Inland Revenue will receive more money for debt collection
- Inland Revenue will receive more money to chase the 'hidden economy' (i.e. cash jobs)
- Inland Revenue will receive more money to audit land sales.

The Last Word

The recent stupidity of Inland Revenue in its approach to limiting the self-employed access to the donations rebate highlights its lack of social skills.

The donations rebate is in place to encourage philanthropic giving.

Inland Revenue has no place discouraging such activity.

Social measures (donations rebate, working for families, child support etc) should not be managed by a department of state focused on collection rather than giving. It will never have the right attitude or approach to such measures.

Many Kiwi's move to Australia thinking that tax rates are lower.

Recent work by the OECD proves this a myth and with the tax cuts announced in the Budget the myth just got bigger.

Australia has stamp duties, land taxes and CGT and the State Governments have charges not to be forgotten.

ON THE SPOT ADVICE

Our telephone/fax/email consultation service is available to enable practitioners to deal with any questions as they arise.

TAX OPINIONS

Providing fully researched opinions on the taxation effect of transactions.

TAX AUDITS

Reviewing tax compliance requirements (FBT, GST, PAYE etc) to identify any deficiencies prior to any visit from tax inspectors.

TAX DISPUTES

Preparation of responses to disputes with Inland Revenue.