

Qualifying companies – changes

This factsheet is for qualifying companies (QCs) and loss-attributing qualifying companies (LAQCs). It explains the changes to the QC and LAQC rules, and the options for existing QCs and LAQCs to transition into a different tax structure.

Note: The information in this factsheet is in Part 11 of the *Qualifying companies (IR 435)* guide, which will be updated in April 2011.

This factsheet provides a general overview of the qualifying company changes. For more information see our *Tax Information Bulletin* Vol 23, No 1 (February 2011).

What's changing?

There are changes to the:

- qualifying company rules, including rules for LAQCs
- non-qualifying company rules.

And a new entity, a look-through company (LTC), has been created. Look-through means that we look through the company to its shareholders and tax them on the profit, not the company. Read our *Look-through companies (IR 879)* guide, available April 2011, for more information.

How will this affect existing companies?

For income years starting on or after 1 April 2011:

- LAQCs will no longer be able to attribute losses to shareholders. Existing LAQCs will be taxed in the same way as ordinary QCs.
- Existing QCs or LAQCs will, by default, continue to be covered by the amended QC rules.
- Elections to be a QC or an LAQC will not be able to be made. If a company is not a QC or LAQC for their income year prior to the income year starting on or after 1 April 2011 they won't be able to become a QC.
- Owners of an existing non-qualifying company can elect to become an LTC by completing a *Look-through company election (IR 862)* form. You must send us your company's election before the start of the income year in which the company wants to be an LTC.
- When an existing non-qualifying company becomes an LTC, its owners are usually treated as having an amount of taxable income equal to their proportion of the company's reserves that would be taxable if the company was liquidated and assets distributed to shareholders.

- However, existing QCs and LAQCs can transition to another entity, such as an LTC, partnership, limited partnership or sole tradership, within a two-year transition period without any amount of taxable income.

How can a company transition?

Existing QCs and LAQCs can choose to:

- remain a QC without being able to attribute losses to shareholders—this is the “default” option if you do nothing
- transition into the look-through company (LTC) rules
- transition into a partnership or a limited partnership
- transition into a sole tradership (if the QC or LAQC has only one natural person as shareholder)
- revoke their QC or LAQC election and become an ordinary close company.

How to make the transition

QCs or LAQCs that exist in the income year immediately prior to the income year starting on or after 1 April 2011 can transition into the new LTC rules or change to another business entity without tax cost.

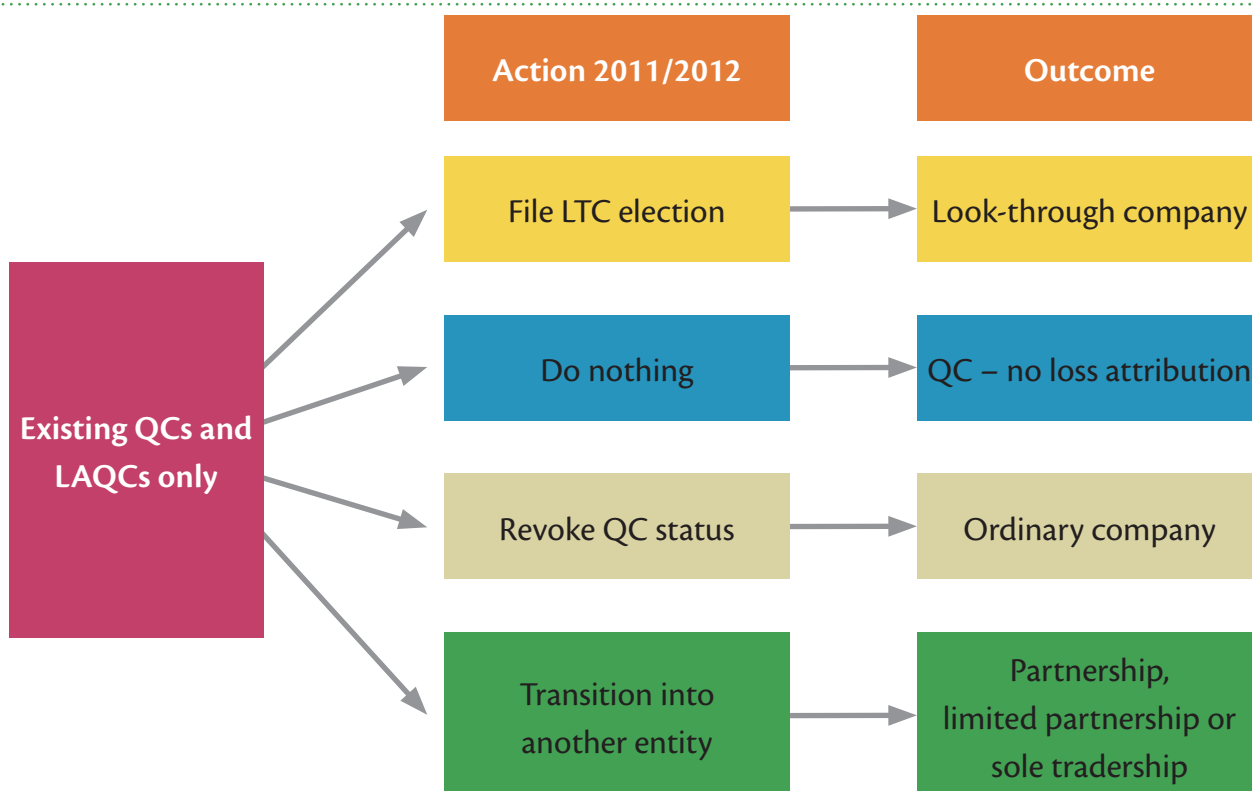
They can transition in either of the first two income years starting on or after 1 April 2011. This will be the company's “transitional year.” If the company chooses to transition during the second year, it must have been a QC for the first of the two possible transitional years.

Transitioning companies must notify Inland Revenue within six months from the start of their transitional year. We'll apply the tax treatment for the entity they transition into (eg, LTC, partnership, sole tradership) from the start of the transitional year.

For income tax purposes, the assets, liabilities, tax balances and other obligations of the original entity will automatically transfer to the new entity at no tax cost.

But, if transitioning into an alternative business structure, then transferring assets, liabilities and legal titles from the QC or LAQC may incur other costs.

Transition rules



Transitioning to an LTC

All the shareholders of an existing QC or LAQC must complete a *Look-through company election (IR 862)* form within six months of the start of the transitional income year. A guardian or legal representative must sign for owners under 18 or who can't legally sign the election. This election will revoke the previous QC and LAQC election, effective from the beginning of the transitional year.

There's no tax cost to your company if you make a valid election within the first six months of either transitional year.

Remaining a QC

You don't need to do anything if you want your QC or LAQC to remain a QC. However, the QC won't be able to attribute losses.

Revoke QC status

If you want to cease your company's QC status and continue as an ordinary company you'll need to complete a *Revocation of qualifying company or loss attributing qualifying company election (IR 437)*. See Part 5 of the *Qualifying companies (IR 435)* guide for details.

Transition into a partnership or limited partnership

Existing QCs and LAQCs may transition to become a new partnership or a limited partnership during their transitional year.

If your company wants to do this you must complete a *Qualifying company and loss attributing qualifying company transition (IR 891)* form. There'll be no tax cost to your company if you make a valid election within the first six months of either transitional year and complete the transition by the end of the transitional year.

This transition notification will revoke your company's QC status from the start of the transitional year.

The partners of the new partnership must be the same as the shareholders of the old QC or LAQC. However, for a limited partnership, a company may become the general partner while the shareholders of the QC or LAQC become limited partners.

More than one QC or LAQC can transition into a single partnership or limited partnership. Each QC or LAQC making the transition will need to complete a separate IR 891 and send it to us with details of the other QCs or LAQCs involved.

Transition into sole tradership

An existing QC or LAQC with only one natural person as shareholder can choose to transition into a sole tradership during the first or second transitional year.

You must complete a *Qualifying company and loss attributing qualifying company transition (IR 891)* form to tell us your intention to become a sole tradership. The transition will have no tax cost from the start of the transitional year, if you notify us within six months from the start of that year and complete the transition by the end of the transitional year.

This transition notification will revoke your company's QC status from the start of the transitional year.

Losses carried forward

Any QC's loss balance carried forward, and any LAQC's controlled foreign company (CFC) or foreign investment fund (FIF) losses carried forward may be used by the owners of the LTC/sole tradership/partners in future years against their share of net income from the new entity or by the sole tradership. The normal country ring-fencing rules in the Income Tax Act 2007 will continue to apply to any CFC or FIF losses carried forward.

Completing the transitional process

If your QC or LAQC keeps its QC status, or transitions into an LTC, it will retain its corporate identity and carry on under the new rules from the start of its transitional year. If it remains a QC, this will be for income years starting on or after 1 April 2011.

If your QC or LAQC is transitioning into another entity we'll transfer the existing tax registrations, obligations and liabilities of the QC or LAQC into the new entity. We'll tell you if the new entity will need any new IRD or GST numbers.

Companies transitioning into a partnership or sole tradership must complete the process by the end of their chosen transitional year. Income and expenses during that year can be treated as incurred by the partnership or sole tradership for tax purposes, even if these were actually incurred during a part of the transitional year when the business was still in company form.

Companies that don't complete the transition by the end of the transitional year will be taxed as an ordinary company for that year.

Under the transitional process no tax costs will result from the transfer of assets, liabilities and any relevant rights and obligations from the QC or LAQC to the partnership or sole tradership.

The historical tax position of the QC or LAQC will also transfer to the partnership or sole tradership.

Memorandum account balances, available subscribed capital accounts and other related tax accounts for the company (including imputation credit account balances) before the transition will be cancelled.

The company effectively becomes a "shell company" and may then be liquidated or written off the Company Register in due course. ("Shell company" means a company with no assets and not trading.)



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