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BUDGET FACT SHEET

Proposed Changes to LAQC/QCs

Loss Attributing Companies (LAQCs) and Qualifying Companies (QCs)

The Budget outlined proposed changes to both LAQCs and QCs, which will result in them being treated similarly to partnerships. These changes are planned to be effective from 1 April 2011 but an officials paper on the changes is open for submission until 5 July 2010.

Any profit or loss derived by the LAQC/QC will flow through to the shareholders in proportion to their shareholding. The shareholders will then be taxed on the income attributed to them at their marginal tax rates. QCs will be required to file an IR7 partnership tax return instead of an IR4 company tax return.

On transition from an 'old' LAQC/QC to a 'new' QC, the imputation credit balance of the 'old' LAQC/QC will be extinguished. The payment of a dividend to utilise the imputation credits before they are extinguished should be considered keeping in mind how much cash is available in the LAQC/QC. A taxable bonus issue could be considered if cash is a problem.

Any losses currently held in a QC will be 'ring-fenced' from the date the new rules take effect and will only be able to be used to off-set future profits the QC derives. This is not an issue for LAQCs as losses are always attributed to shareholders on an annual basis. Loss limitation rules will apply to limit the losses attributed to a shareholder to the extent of their investment in the 'new' QC.

Once the new rules take effect, any sale of shares in a QC will be a deemed disposition of the underlying property held by the QC. This creates potential tax consequences, such as depreciation recovery for the vendor, as well as having assets at different values for different shareholders.

If an LAQC/QC is expecting to make profits in the future it may be worthwhile exiting the QC regime to prevent the profits flowing directly to the shareholders. It would also be advisable to exit the regime before 1 April 2011 (the likely date of change) otherwise there could be a deemed disposal of the QC's underlying assets if the exit is on 1 April 2011 or later.