

MARKHAMS UPDATE

RIP LAQC

The long awaited tax changes relating to the current Qualifying (QC) and Loss Attributing Qualifying Company (LAQC) that were announced on Budget day have now been released. The aim of this new legislation is to ensure that both income and losses are attributed to shareholders and taxed at their marginal rates.

In releasing this draft legislation, the government announced that parts of it are still to be drafted but they have clearly set out the framework for the new rules. The government's response to the large number of submissions lodged in reference to their initial proposals was to rework them into something that is more in keeping with the original concept of the QC regime.

Essentially they have introduced a two stage process. The first stage is to remove the ability to attribute losses from an LAQC to its shareholders effective from 1 April 2011. Other than this the QC regime is left untouched for the time being.

The second stage is a wide ranging review of dividends for closely held companies with the intention of simplifying the rules. This broader review will affect a significant number of companies and in particular the use of QCs may no longer be required. This change may be at least 12 months away.

The new legislation provides the following:

- LAQCs will no longer be able to attribute losses to individual shareholders from 1 April 2011.
- A new elective flow through tax regime will be introduced creating a new entity called a Look Through Company (LTC) – this is a tax status only; the company retains its identity and still governed by the Companies Act 1993.
- Special rules are included to allow QCs and LAQCs to transition to LTCs or another legal entity without triggering an immediate tax cost (eg: depreciation recovered). Examples of other entities that can be used are partnerships, ordinary companies, sole traders.

Each option available has various implications and requirements that must be worked through within specified time frames in order to ensure that no tax cost arises through the transition period.

The new LTC provides a transparent entity under which income and losses of the company flow through to the shareholders. The pass through of losses will be limited to the level of economic contributions of the shareholders. There are also limits to the number of shareholders permitted – similar to the existing QC regime. Under this regime, future share transfers within the company may also give rise to unintended tax consequences, which is why a simple transfer from an LAQC to an LTC may not be the best option to take.

This new legislation is still in draft with some sections yet to be written. It is expected that this legislation will be passed in full prior to the end of the year.

Markhams is putting a programme in place to ensure that all our clients in the QC / LAQC regime are reviewed and appropriate recommendations made with regard to structure going forward. However, we are awaiting the full legislation to be enacted to ensure that any recommendations made are the most appropriate in accordance with the law, and will still achieve what you set out to do initially.

What we do know under the framework that has been released, is that taking no action is not an option. If you are a shareholder in an LAQC and you do nothing, the losses derived in your company post 1 April 2011 will be trapped in the company – which means no personal tax deduction against other income and no Special Tax Code available.