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### LAQC's

Everybody who has seriously started to look at property investment would have come across someone talking about an LAQC. (Note that LAQC's have a wider usage than just for property ownership, but for the purposes of this article I will only deal with it in a property context).

Property ownership can be any of the following

- Sole Trader (individual name)
- Company
- Partnership
- Loss Attributing Qualifying Company
- Family Trust
- Trading Trust

All these ownership structures have their own advantages and disadvantages and I strongly recommend that you consult your professional advisors (Lawyer and Accountant) on the tax implications of your particular circumstances.

In this instance I hope to explain LAQC's

So what are they?

#### **Loss Attributing Qualifying Company**

LAQC is an abbreviation for **Loss Attributing Qualifying Company** and was allowed for under the qualifying company regime and the Income Tax Act 1994.

It is for tax purposes, to treat loss attributing companies in a similar way to partnerships by treating the separate shareholders in the companies as individuals. So the individual's taxation position would be exactly the same as if they had their percentage shareholding invested in their own name. The advantage is that the shareholders get the benefit of the limited liability protection, and also get the benefit of tax losses made by the company through reducing their personal taxable income, thus reducing their tax payable.

## **Advantages**

In summary, company tax losses can be attributed to the individual shareholders income in proportion to the percentage shareholding they have in the company.

Another advantage of loss attributing companies is their ability to allow the shareholders to tax free access to capital gains without having to liquidate the company.

## **Disadvantages**

Shareholders must elect to become personally liable for any tax liability of the company

### **To become a qualifying company:**

- Ø Each shareholder must be one of the following, a natural person, another qualifying company, or a trustee of a trust of a specified kind (see "Trustee shareholder rules" on page 18 of IRD's booklet *Qualifying companies (IR 435) February 2001* for more details).
- Ø The company must have no more than five shareholders at all times, unless it is purely a flat-owning company. Shareholders related within one degree will count as one shareholder (see "Shareholder count test" on page 12 of IRD's booklet *Qualifying companies (IR 435) February 2001* for further details).
- Ø All Directors' and shareholders must elect in writing that the company become a qualifying company. The shareholders must also elect to be personally liable for their share of any income tax not paid by the company for each year the election is in force (*form IR 436*).
- Ø If a shareholder is a trust, all the trustees and at least one of the beneficiaries with full capacity must make elections.
- Ø The company cannot derive more than \$10,000 in offshore sourced income in any one year;
- Ø All shareholders must elect to be severally liable for their proportionate share of the qualifying company's income tax.

### **So how does it work?**

Mr and Mrs Shareholder wish to purchase an investment property with the long-term view to giving them income in retirement via the rent received from their property.

Your personal circumstances will determine the most appropriate structure for you. However, maximisation of the tax advantage will often be the deciding factor.

Eg, Mr Shareholder earns \$85,000 and Mrs Shareholder earns \$25,000.

How could they maximise their advantage if their rental property makes a \$15,000 loss?

In New Zealand, the current tax rate tiers are

Individual Tax Tables			
Lower Threshold	Upper Threshold	Tax Rate	Tax on Band
	\$14,000	14.5 %	\$2030.00
\$14,001	\$48,000	21 %	\$7,139.79
\$48,001	\$70,000	33 %	\$7,260
\$70,001		38 %	

It will therefore be to Mr & Mrs Shareholder s' advantage to claim all losses against Mr Shareholder's income so that the tax saving is at 38c, not any lesser rate. i.e., if all the loss is claimed against Mr Shareholder's income, the refund is \$5,700. If the loss is split, the total is only \$4,425.00. Tax saving of \$1,275.00 is therefore lost to Mr & Mrs Shareholder.

The challenge is then to create a structure that is both tax efficient, and easy to manage. The Inland Revenue Department will not allow your structure to be altered simply to suit your changed tax circumstances. It is therefore important to look at an effective long-term structure if, for example, losses are expected in the early years and then profits in later years.

Another benefit of LAQC's and one that I have recommended my clients use often is when residential property and residential investment property is owned with some debt not tax deductible.

An actual example follows.

Jack and Jill (names obviously changed) had been in a defacto relationship for approx 2 years and a year ago decided to buy a home in joint names to live in. The home cost \$215,000 and they borrowed \$155,000 from a leading bank. None of this debt was tax deductible because the asset purchased with the mortgage was not income producing (use of money rule). Jill also retained her previous home that was now being rented out. This property was worth \$135,000 and had no debt on it. The obvious solution would be to say \$135,000 of the debt was on the rented property. That would not pass the use of money rule; the Inland Revenue Department applies to allow interest costs to be tax deductible.

The solution was to set up an LAQC with Jill the sole shareholder; however as they had been together over two years and incomes were both in the high \$30,000s company was set up on a 50/50 basis. The company bought the investment property at the registered valuation of \$135,000, borrowed the money and paid this to Jill who then repaid it of their home loan. Thus saving themselves approx \$2,000 in tax per annum.