Fact sheet: QCs and LTCs — Explaining the features

Companies have two tax status options on incorporation:

- Standard
- Look Through Company (LTC)

Previously, the Qualifying Company (QC) regime was also an option. However, there can be no new elections to this regime for income years beginning on or after 1 April 2011.

A QC could also have Loss Attributing Qualifying Company (LAQC) status. For income years starting on or after 1 April 2011 existing QCs and LAQCs can continue to use the QC rules, but LAQCs no longer have the ability to attribute losses.

Standard

Under the standard tax status all losses generated by a company must be held in the company until future profits offset them. A company may also make its tax loss available to offset the net income of another group company. Capital gains can only be distributed to shareholders tax free from a Standard tax status company on liquidation.

LTCs

An LTC (Look Through Company) exists for tax purposes only. An LTC retains its identity as a registered company and is therefore still governed by the Companies Act.

To become an LTC, a company must meet all the eligibility criteria for the whole of the income year. If there is a breach, the company cannot use the LTC for that tax year or for the two tax years following.

- Generally, an LTC's income, expenses, tax credits, gains and losses are passed on to its owners. These are allocated to owners in proportion to the number of shares they have in the LTC. Owners can also deduct expenditure incurred by the LTC before they became a member, if they pass certain tests
- Any profit is taxed at the owner's marginal tax rate. The owner can use any losses against their other income, subject to the loss limitation rule
- For the 2017 income year and prior, the loss limitation rule ensures that losses claimed reflect the owner's economic loss in the LTC. However for the 2018 income year and following, in most circumstances the loss limitation rule will not apply
- The owners of an LTC are treated as holding the LTC's property directly in proportion to their shareholding. When owners sell their shares they are treated as disposing of their share in this property and may have to pay any tax associated with this, if certain thresholds are exceeded
- If the LTC ceases to exist or becomes an ordinary company, the owners are considered to have disposed of their shares at market value
- Look-through applies for income tax purposes only. Under company law an LTC retains its corporate obligations and benefits, such as limited liability
- An LTC is still recognised separately from its shareholders for:
    - GST (goods and services tax)
    - PAYE and employer tax responsibilities
    - FBT (fringe benefit tax)
    - RWT and NRWT (resident and non-resident withholding tax)
    - ESCT (employer superannuation contribution tax) and
    - RSCT (retirement scheme contribution tax)
    - The income tax rules for company amalgamations

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The Main Advantage of being an LTC

An LTC may be a popular entity for certain small enterprises because losses can flow through to a shareholder.

The Main Disadvantages of being an LTC

Profits are taxed at the marginal rate not the corporate rate. And of course there are the usual costs related to statutory compliance for companies.

QCs

QCs are companies governed by tax provisions that aim to treat the company and its shareholders as one entity as much as possible for income tax purposes. A QC pays income tax on its profits in the same way as other companies (subject to certain rules). The advantages and disadvantages of retaining QC status are outlined below.

The Main Advantages of being a QC

- There are commercial benefits in maintaining a company structure (e.g., limited liability and the ability to transfer ownership)
- Only dividends with imputation credits attached are taxable to the shareholders
- Capital gains (realised and unrealised) can be distributed tax free without winding up the company

The Main Disadvantages of being a QC

- Shareholders are liable for any unpaid income tax for the company according to their effective interest
- A QC in profit can only make a subvention payment to, or receive a loss offset from, another group company if it is also a QC
- Interest shareholders have paid to acquire shares isn't fully deductible

Our Recommendation

There is no longer one recommendation which will generally suit all situations. Please contact us to discuss your situation and the best option for you. We can then arrange for the appropriate documentation to be completed.

Last reviewed on 20 February 2018

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