Look Through Company (LTC) Explained

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What is a Look Through Company (LTC)?

A Look Through Company (LTC) is an ordinary limited liability company in all legal respects where the shareholders have made an election for tax purposes to enter the LTC regime. The implementation of this regime was signalled in the Government's budget announcement in May 2010 with application from 1 April 2011.

The LTC regime was enacted to address concerns that the government had with the existing LAQC regime. The best way to describe the tax rules that apply to LTCs is to say that for tax purposes an LTC is viewed as a partnership. This means that the shareholders of an LTC (*who are described as owners in the legislation*) are deemed to derive and incur the income and expenses of the LTC.

The LTC does not have a separate identity for income tax purposes. To give an example, if an LTC produces taxable income of $10,000, that $10,000 is taxed as if it had been derived by the shareholder directly in their hands.

Other key elements of the LTC rules are:

- Selling shares of an LTC is deemed to be a sale of underlying property for tax purposes. This is a potentially significant rule. Ordinarily when shares in a company are sold this is not treated as if the shareholders had disposed of property owned by the company. Under LTC rules it will be. This means that depreciation recovery or triggering of income tax on "tainted" gains is a possibility when shares are transferred;

- The amount of loss that a shareholder can claim out of an LTC is limited to the extent of their "investment" in the LTC. Investment, broadly speaking, is measured by the sum of amounts paid to acquire the shares in the LTC, plus advances to the LTC plus the lesser of (a) shareholders share of LTC debt guaranteed and (b) share of assets that back such guarantee less losses previously claimed and profit distributed.

Benefits of LTCs

We see LTCs having wide application. For example, they are an alternative to limited partnership or joint venture structures. Previously if two parties enter into business together and wanted profits or losses from their joint undertaking to be dealt with separately, they were faced with either utilising an unincorporated joint venture or a more complex limited partnership. Use of an LTC will be attractive in such circumstances.

We also see LTCs as being widely used in the property industry where, despite the fact that depreciation can no longer be claimed on buildings, there is still going to be a prospect of the production of tax losses.

LTCs still allow for shareholders to claim tax losses against their other taxable income. The limitation of loss rule in relation to LTCs will not likely impact most property investors as if they hold the shares personally, they will also be personally guaranteeing any bank debt which will likely see their "investment" in the company high relative to the tax loss produced.

LTCs provide all of the benefits of an ordinary limited liability company for legal purposes which include:

- Limitation of liability;

- Ability to protect shareholder loans by assigning them to Trust;

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- Ability to change ownership to underlying assets from a legal perspective by moving shares (in other words whilst for tax purposes a disposal of shares equals a disposal of property in an LTC, it is not a legal disposal of property so no conveyancing is involved).

What has Happened to LAQCs?

The new rules effectively ended the LAQC regime from 1 April 2011.

The implication of this is if you had an LAQC that was producing and will continue to produce tax losses you most likely need to take action as doing nothing will see the company remain a QC and subject to the new rules which would see losses locked within the company.

Difference between LAQCs and LTCs

Some of the key elements of LTCs are as follows:

- All shareholders sign the initial LTC election;
- LTC elections can only be revoked by a shareholder and can only be revoked prospectively;
- Has to have five or fewer shareholders. Note there are special count rules that apply to this and shareholders have to be trusts or natural persons;
- No limits on the amount of foreign income that may be earned;
- Profits and losses flow through to shareholders for tax purposes;
- Losses able to be claimed by shareholders are limited to their “investment” into the LTC;
- Disposal of shares in an LTC is treated as disposal of underlying assets with the consequential tax implications although there are de minimis thresholds.

Contrasting these rules to LAQC rules we note the following:

- Both shareholders and directors have to sign LAQC elections and LAQC status is lost if shares are transferred and no election signed by a new shareholder;
- LAQC status can be revoked by directors or shareholders retrospectively;
- There has to be five or fewer shareholders. There are special count test rules that apply to this;
- There is a limit on the amount of foreign income that may be derived (ie NZ$10,000).
- Up until 1 April 2011 there was no limitation on the amount of loss that can be claimed from an LAQC.
- Until 1 April 2011 LAQC losses were attributed to shareholders but profits are company profits and subject to company tax rules. From 1 April 2011 losses are not attributed to shareholders;
- Sale of LAQC shares does not equal sale of the underlying property for tax purposes;

LTC Versus Partnerships

Given that the tax rules that apply to LTCs are largely the same as that which apply to partnerships an obvious question that arises is whether one should set up an LTC or operate an ordinary partnership.

Relevant points to note in relation to this are:

- LTCs are still limited liability companies so offer limited liability protection. This means an LTC will be a vastly preferred structure for any sort of business where limited liability is important;
- For legal purposes it will be advantageous to hold property in an LTC as opposed to a partnership. Movement of shares in an LTC will not involve conveyancing and furthermore, whilst there may be tax consequences such as depreciation recovery, there are de minimis thresholds in place for LTCs which do not apply to partnerships;
- Equity will be more readily protected in Trust if property is held via an LTC as opposed to a personal partnership. For example loans to the LTC can be assigned to your Trust and potentially unrealised gains can still be declared as dividends with the resulting current accounts assigned to Trust as well. The partnership will not afford this sort of opportunity;
- A drawback of operating the LTC structure is that accounting will be more complex as there will need to be monitoring of the claiming of losses to ensure that the loss limitation provisions are not contravened.

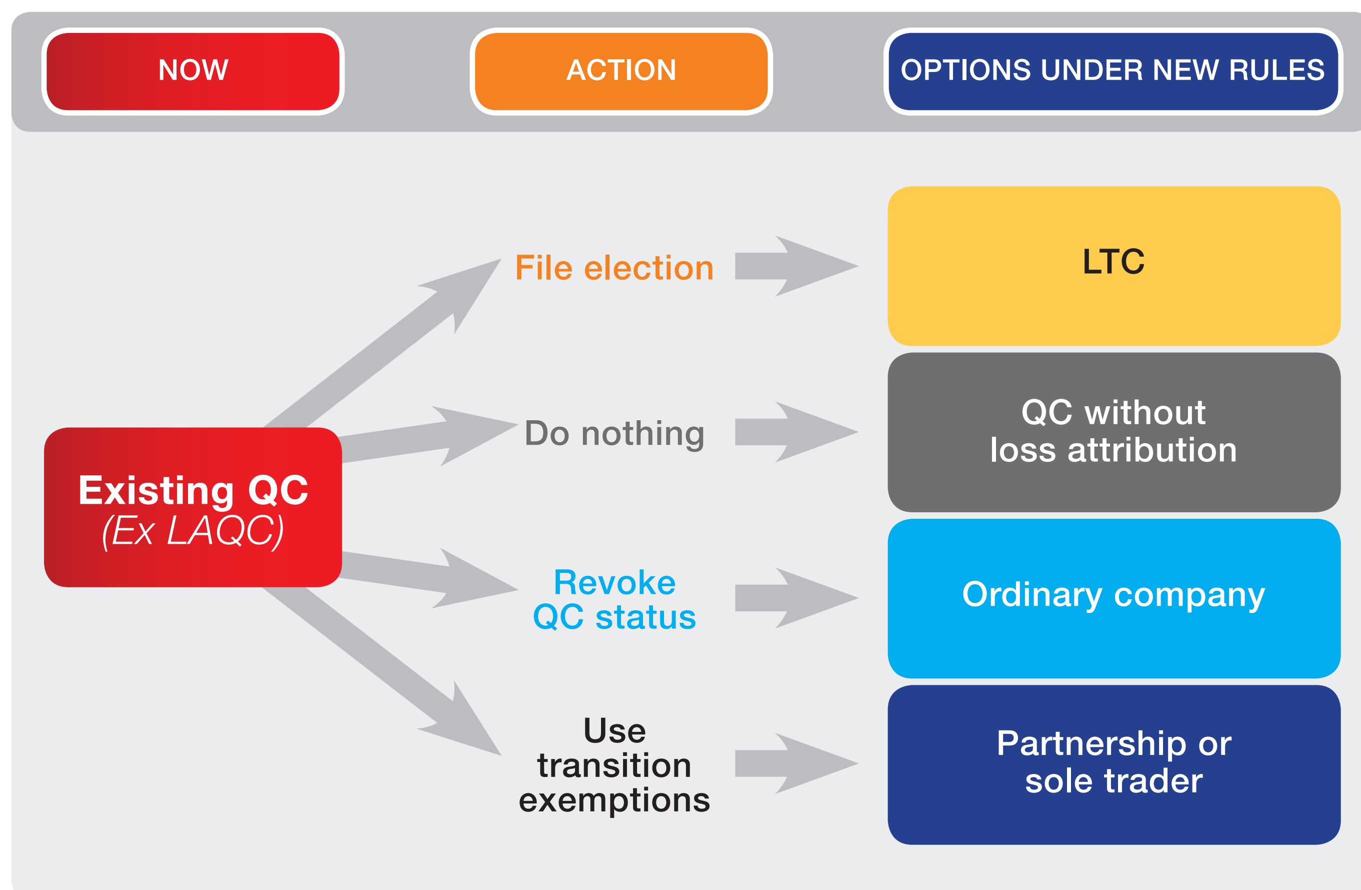
Transitions Options

If you have a QC at present you have four options available to you until 30 September 2012. They are as follows:

1. Do nothing and remain in the QC regime. This will effectively see your company be treated according to the existing qualifying company rules in that there will no longer be any ability to attribute losses to shareholders;
2. Elect into the LTC regime. This will see the QC converted into an LTC. If there are tax losses being produced this will, in all likelihood, preserve the shareholders' ability to utilise those tax losses although this will be subject to the loss limitation rules;
3. Revoke QC status and become an ordinary company. This will see the company revert to ordinary company status with the tax rules applicable to ordinary companies applying from 1 April onwards. This could be beneficial where a tax profit is produced as the company tax rate is 28%;
4. Take advantage of the transitional provisions which allow the business and assets of a QC to be transitioned into a sole tradership or partnership without any tax cost. Note although there is no tax cost there is still legal costs if property is involved as it would involve full conveyancing.

Following the above, if you have a QC you need to seek advice immediately and map out an action plan as to which structure will be employed for the undertakings of the LTC post 1 April 2012.

Your Options and Actions



Need Help?

At GRA, we have made it our mission to provide the most up-to-date and best advice with when it comes to LTCs. We have a dedicated team of people working daily in the property structures area. Out ability to provide both legal and accounting advice that combine to help clients achieve their goal in the most tax-efficient way is what we specialise in.

If you would like more information about LTCs or any other matter involving property or your financial future, please contact us (world-wide) **+64 9 522 7955** or **09 522 7955** (*NZ only*). Alternatively, email us at **info@gra.co.nz**

Thank you for taking the time to read our report.

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