



Tax policy report: Confirmation of Budget decisions on loss attributing qualifying companies

Date:	20 April 2010	Priority:	Critical
Security Level:		Report No:	T2010/650 PAD2010/071

Action sought

	Action Sought	Deadline
Associate Minister of Finance	Sign and refer to the Cabinet Office	20 April 2010
Minister of Revenue	Sign and refer to the Cabinet Office	20 April 2010

Contact for telephone discussion (if required)

Name	Position	Telephone	
Andrew McLoughlin	Senior Analyst, The Treasury	[deleted - privacy]	[deleted - privacy]
Peter Frawley	Policy Manager, Inland Revenue	[deleted - privacy]	[deleted - privacy]

20 April 2010

Associate Minister of Finance
Minister of Revenue

Confirmation of Budget decisions on loss attributing qualifying companies

Please find attached a paper seeking confirmation of Cabinet's decision to make qualifying companies and loss attributing qualifying companies full flow-through entities for income tax purposes, for you to sign and refer to the Cabinet Economic Growth and Infrastructure Committee for its meeting on 21 April 2010.

Recommended action

We recommend that you **sign** and **refer** the attached paper to the Cabinet Office for the Cabinet Economic Growth and Infrastructure Committee meeting on 21 April 2010.

Signed and referred

Signed and referred

Andrew McLoughlin
Senior Analyst
for Secretary to the Treasury

Peter Frawley
Policy Manager
Policy Advice Division

Hon Simon Power
Associate Minister of Finance

Hon Peter Dunne
Minister of Revenue

Cabinet Economic Growth and Infrastructure Committee

Confirmation of Budget decisions on loss attributing qualifying companies

Introduction

1. On 12 April 2010, Cabinet agreed to replace the current qualifying company and loss attributing qualifying company (LAQC) rules with full flow-through treatment for income tax purposes (similar to the rules currently applying to limited partnerships), to apply for income years commencing on or after 1 April 2011 (CAB Min (10) 12/10 refers). Cabinet also agreed to the release of an officials' paper for public consultation on the implementation of these changes.

2. In preparing this advice, the Minister of Finance and the Minister of Revenue considered whether LAQCs as a class of entity should be abolished altogether. Following advice from officials the Ministers agreed not to proceed with that option. The Minister of Finance has asked the Associate Minister of Finance and the Minister of Revenue to review that earlier decision to ensure the integrity of the decision making process in relation to this issue.

Options

3. Tax policy officials considered that the present LAQC rules were no longer appropriate, and provided advice to the Minister of Finance and Minister of Revenue on two options to improve the integrity and coherence of the tax system.

4. The first option, preferred by officials, was to replace the current rules with a new set of rules to make qualifying companies and LAQCs full flow-through for income tax purposes, similar to the treatment of limited partnerships. Both the income and losses would be passed on to the shareholders, so income would be taxed and losses deducted at a shareholder's marginal tax rate. As a result, there would be no arbitrage opportunities due to the difference between company tax and higher personal tax rates.

5. This option is more consistent with the original intention of these rules, which was to provide shareholders of closely-held companies a form of partnership treatment for income tax purposes, while maintaining the corporate protections afforded under general law.

6. The second option was to repeal the current qualifying company and LAQC rules which would have resulted in the standard company treatment applying. Income and losses would

be quarantined at the company level. However, it is possible for current qualifying companies to transfer to the limited partnership rules, which also provides limited liability but with flow-through tax treatment. This would have imposed significant compliance costs on taxpayers for no revenue gain.

7. Therefore, we consider that the first option that was agreed to by Cabinet is, on review, the best option. This paper seeks confirmation of that Cabinet decision.

Recommendations

We recommend that the Committee:

8. **Note** that Cabinet agreed to replace the qualifying company and LAQC rules with full flow-through treatment for income tax purposes, and to release an officials’ paper for public consultation on the implementation of the changes (CAB Min (10) 12/10 refers).

9. **Confirm** the following prior decisions:

- 1. replace the current qualifying company and loss attributing qualifying company rules with full flow-through treatment for income tax purposes (similar to the rules currently applying to limited partnerships), for the income years commencing on or after 1 April 2011; and
- 2. the release of an officials’ paper for public consultation on the precise legal mechanism to implement these changes.

Simon Power
Associate Minister of Finance

Peter Dunne
Minister of Revenue

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Date

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Date