

Company structure a tax-wise way to own rental housing

OWNING investment property can be more tax-efficient when you use a company structure. A qualifying company that achieves tax department status as a "loss-attributing qualifying company" allows losses to be allocated to shareholders based on their effective company shareholding.

We outline below some of the advantages and disadvantages of the LAQC structure. We note that tax planning must not be the primary reason for a change in entity when restructuring existing asset ownership. Genuine commercial reasons must be present. These may include separating ownership of risk assets, a vehicle to own similar investments, equity protection of your private assets by restructuring debt, clear identification of investment assets and family assets, ease of refinancing a group of properties and achieving better deals from banks, property managers and such like. As to advantages,



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shareholders can offset the company losses against their taxable income. This can result in tax refunds, if other income has certain types of sourced deducted tax, such as PAYE income tax. Where a tax loss in the next year is reasonably foreseeable, we can complete a simple forecast, fill out an IRD form and your employer can lower your PAYE.

An LAQC allows losses to be allocated to shareholders based on their effective company shareholding. This allows for different percentage of ownership and loss allocation for multiple shareholders.

Capital gains (realised and unrealised) can be distributed tax-free without liquidating the company. In effect, the dividends paid by a qualifying company are either tax-free to the individual shareholders or have maximum imputation credits attached.

If the company makes a profit, then the company will pay tax at 33 per cent, which is lower than the top tax rate paid by individual tax payers who have gross income above \$60,000 a year.

Non-cash dividends distributed to shareholders of qualifying companies who are not employees are not subject to FBT.

Ability to ensure debt-efficient structures: interest paid on loans secured against invest-

ment properties is tax deductible. You can use equity in other property, normally the family home, to maximise the debt in the name of the company. This can mean the company can have a loan that is equal to 100 per cent of the purchase price of the investment property.

Flexibility to restructure investments, including the ability to sell or transfer the company shares to a family trust without invoking depreciation clawback provisions or incur additional legal costs such as the need to carry out land conveyancing: upon death, the shares in the company can be passed to the intended beneficiaries, avoiding the new depreciation clawback provisions on inheritances. The beneficiaries then also gain the advantage of being able to continue to claim depreciation against the investment properties.

Asset protection by having direct owner-

ship of the assets in the name of the company, not the individual: though the shares are owned in the name of the individual, asset protection is only limited.

As to the disadvantages, shareholders become personally liable for a share of any of the company's income tax liabilities. There is also the inability to group with other non-qualifying companies to offset available net loss against net.

Any company net losses from previous years are forfeited upon the company becoming an LAQC. There are continuing compliance costs, including the need to complete company financial statements and a company income tax return.

For current property investors, there will be depreciation-recovered issues when the property is sold/transferred to an LAQC.

There will also be conveyancing costs and possibly refinancing costs. Some of these

costs may not be tax deductible. If an existing property owned individually is transferred/sold into an LAQC where the shareholders are effectively the same as the individual, then the sale must take place at market value. However, you need special approval from the IRD to be able to depreciate the asset at the new market value. Such a transfer will include depreciation recovered for the individual and at worst the LAQC will be able to depreciate the property at the original cost to the individual. When a company becomes an LAQC, a tax called Qualifying Company Entry Tax may be payable.

■ *Hamish Edwards is a chartered accountant and managing director of Edwards Account- ing Ltd and a contributor to the Biz Centre. For more information on a wide range of business development services for small- to medium-sized businesses throughout New Zealand see www.thebizcentre.co.nz.*