

**EXPOSURE DRAFT - FOR COMMENT AND DISCUSSION ONLY | HUKIHUKI HURANGA
- MŌ TE TĀKUPU ME TE MATAPAKI ANAKE**

Deadline for comment | Aukatinga mō te tākupu: **27 November 2026**

Please quote reference | Whakahuatia te tohutoro: **PUB00535**

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QUESTIONS WE'VE BEEN ASKED | PĀTAI KUA UIA MAI

Income tax: Continuity of business activities – carrying forward losses arising in the income year of ownership continuity breach

Issued | Tukuna: Issue date

QB XX/XX

This “question we’ve been asked” (QWBA) provides guidance on how the continuity of business activities rules in subpart IB of the Income Tax Act 2007 apply to losses arising in the income year in which a company breaches the continuity of ownership requirements. Uncertainty has arisen about whether that income year is an “earlier income year” under s IB 3(2), such that the losses can be carried forward. This QWBA confirms losses incurred in the income year of an ownership continuity breach can be carried forward. It is relevant to companies that have both an ownership continuity breach and a tax loss arising in the income year of the breach.

All legislative references are to the Income Tax Act 2007, unless otherwise stated.

Key provisions | Whakaratonga tāpua

Income Tax Act 2007 – ss IA 3(4) and 3(6), IA 5(4), IB 1, IB 3(1) and (2) (see the Appendix).

Question | Pātai

Can a company use the business continuity test to carry forward a tax loss component arising in the income year of an ownership continuity breach?

Answer | Whakautu

Yes. If the requirements of s IB 3 are met, a company can use the business continuity test to carry forward a tax loss component arising in the income year of the ownership continuity breach. The breach year is an “earlier income year” under s IB 3(2) when compared with the later tax year to which the loss is carried forward.

Key terms | Kianga tau tāpua

Business continuity test means the requirements in subpart IB that allow a company to carry forward tax loss components despite a breach of the continuity of ownership requirements. Broadly, the company must continue its business activities during the business continuity period, without a disqualifying major change in the nature of those activities.

Ownership continuity breach has the meaning given in s IB 2. Broadly, it is a breach of the continuity of ownership requirements in s IA 5.

Tax loss component has the meaning given in s IA 2(7). Broadly, it includes the person’s net loss for the tax year under s BC 4, specified amounts described in s IA 2(4) and certain unused losses from years before the 2008-09 tax year.

Explanation | Whakamāramatanga

The issue

1. A company may generally carry forward a tax loss component only if it satisfies the continuity of ownership requirements in s IA 5. However, if those requirements are not met s IA 5(4) gives the company the option to apply s IB 3 to determine whether some or all of the tax loss component is carried forward.

2. Section IB 3 provides an alternative basis for carrying forward company tax losses where an ownership continuity breach has occurred but business continuity is maintained.¹
3. The issue is whether a company can apply s IB 3 to carry forward a tax loss component arising in the income year of an ownership continuity breach. The issue arises because s IB 3(2) refers to a tax loss component "arising in an earlier income year". As an ownership continuity breach may occur part-way through an income year, it is necessary to identify the comparison year against which an income year is "earlier".

Meaning of "earlier income year"

4. Section IB 3(2) provides that, "Despite the ownership continuity breach, a tax loss component arising in an earlier income year is carried forward to a tax year in a loss balance under section IA 3(4)". This gives rise to a question as to whether the "earlier income year" must be a year before the year in which the ownership continuity breach occurs, given the provision is triggered by such a breach yet applies despite that breach.
5. If that were the case, a tax loss component arising in the income year in which the ownership continuity breach occurs may fall outside the business continuity test, creating uncertainty as to its treatment.
6. In the Commissioner's view, a court would resolve this uncertainty by preferring an interpretation of s IB 3(2) under which the reference to an earlier income year is directed to the tax year to which the tax loss component is carried forward, rather than to the year in which the ownership continuity breach occurs.
7. On this interpretation, the relevant comparison is between the income year in which the tax loss component arose and the later tax year to which it is carried forward. Therefore, the comparison is not with the income year in which the ownership continuity breach occurs. Accordingly, a tax loss component arising in the income year in which an ownership continuity breach occurs may be carried forward subject to the business continuity test.
8. The potential uncertainty arises because s IB 3(2) does not expressly identify the year of the ownership continuity breach as the relevant comparator to the earlier income year, nor does it expressly link this phrase to the year to which the tax loss component

¹ For more information on the business continuity test see IS 22/06: Loss carry-forward – continuity of business activities, *Tax Information Bulletin* Vol 34, No 11 (December 2022): 23. See also IS 22/07: Company losses – ownership continuity, sharing and measurement *Tax Information Bulletin* Vol 34, No 11 (December 2022): 53.

is carried forward. Therefore, the text is capable of supporting either interpretation and must be read in light of its context and purpose

Statutory context and purpose

9. The purpose statement in s IB 1 supports the Commissioner's interpretation. Reading s IB 3(2) as excluding a tax loss component arising in the breach year could prevent that component from being carried forward, despite the company satisfying the business continuity test. Such an outcome would be inconsistent with the purpose of subpart IB, which is to permit the carry forward of tax loss components despite an ownership continuity breach where business continuity is maintained.
10. This interpretation is consistent with the ordinary process for carrying forward tax losses. Under s IA 3(4), a remaining tax loss balance for a tax year is carried forward to a subsequent tax year. Section IA 3(6) confirms that, for companies, s IB 3 modifies the application of that rule. Accordingly, when a tax loss arising in the income year of an ownership continuity breach is carried forward to the next tax year, that income year is an earlier income year as referred to in s IB 3(2). This is illustrated in the Example | Tauira.
11. It is also consistent with s IA 5(4), which identifies ss IB 3, IP 3 and IP 3B as alternatives a company may choose to apply following an ownership continuity breach. In that context, s IB 3 provides an alternative basis for carrying forward a tax loss component.

Example | Tauira – Tax loss arising in the year of an ownership continuity breach

A company has an ownership continuity breach during the 2025-26 income year.

The company satisfies the requirements of the business continuity test and has a tax loss of \$100,000 arising in the 2025-26 income year.

The company carries the tax loss forward to the 2026-27 tax year.

The 2025-26 income year is an "earlier income year" relative to the 2026-27 tax year to which the tax loss is carried forward.

The fact the tax loss arose in the same income year as the ownership continuity breach does not prevent it from being carried forward. Therefore, the tax loss can be carried forward despite the ownership continuity breach.

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References | Tohutoro

Legislative references | Tohutoro whakatureture

Income Tax Act 2007, ss BC 4, IA 2, IA 3, IA 5, subpart IB, IP 3, IP 3B.

Other references | Tohutoro anō

IS 22/06: Loss carry-forward – continuity of business activities *Tax Information Bulletin* Vol 34, No 11 (December 2022): 23.

taxtechnical.ird.govt.nz/tib/volume-34---2022/tib-vol-34-no11

taxtechnical.ird.govt.nz/interpretation-statements/2022/is-22-06

IS 22/07: Company losses – ownership continuity, sharing and measurement *Tax Information Bulletin* Vol 34, No 11 (December 2022): 53.

taxtechnical.ird.govt.nz/tib/volume-34---2022/tib-vol-34-no11

taxtechnical.ird.govt.nz/interpretation-statements/2022/is-22-07

About this document | Mō tēnei tuhinga

Questions we've been asked (QWBAs) are issued by the Tax Counsel Office. QWBAs answer specific tax questions we have been asked that may be of general interest to taxpayers. While they set out the Commissioner's considered views, QWBAs are not binding on the Commissioner. However, taxpayers can generally rely on them in determining their tax affairs. See further [Status of Commissioner's advice](#) (Commissioner's statement, Inland Revenue, December 2012). It is important to note that a general similarity between a taxpayer's circumstances and an example in a QWBA will not necessarily lead to the same tax result. Each case must be considered on its own facts.

Appendix | Āpītitanga – Legislation | Whakature

IA 3 Using tax losses in tax year

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Remaining loss balances carried forward

- (4) If a person has a balance of tax loss remaining for a tax year after the uses described in this section, the balance is carried forward to the next tax year as a loss balance.

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Relationship with section IB 3

- (6) Section IB 3 (When tax loss components of companies carried forward despite ownership continuity breach) modifies the application of this section when the person is a company.

IA 5 Restrictions on companies' loss balances carried forward: continuity of ownership

...

Breach of continuity of ownership in period

- (4) If a tax loss component cannot be carried forward because the requirements of subsections (2) and (3) are not met, the company may apply section IB 3, IP 3, or IP 3B (which relate to the carrying forward of tax losses for companies) to determine whether some or all of the tax loss component is carried forward in a loss balance.

...

IB 1 Purpose

The purpose of this subpart and sections GB 3BA to GB 3BAC (which relate to arrangements involving tax losses) is—

- (a) to enable companies to carry forward tax loss components in loss balances despite not meeting the requirements for continuity of ownership of section IA 5 (Restrictions on companies' loss balances carried forward: continuity of ownership), in order to reduce impediments to—
- (i) innovation and economic growth:
 - (ii) corporate reorganisations:
 - (iii) changes in the direct or indirect ownership of companies:
 - (iv) companies accessing new sources of share capital:
 - (v) companies adapting their business activities in order to grow or be resilient; but
- (b) not to encourage tax avoidance arrangements involving the acquisition of ownership interests in companies.

IB 3 When tax loss components of companies carried forward despite ownership continuity breach*When this section applies*

- (1) This section applies when an ownership continuity breach occurs for a company.

Tax loss components for earlier income years carried forward

- (2) Despite the ownership continuity breach, a tax loss component arising in an earlier income year is carried forward to a tax year in a loss balance under section IA 3(4) (Using tax losses in tax year) if—
- (a) the earlier income year is the 2013–14 income year or a later income year; and
 - (b) the company does not cease to carry on business activities during the relevant period described in section IB 4 (the business continuity period); and
 - (c) no major change in the nature of the business activities carried on by the company occurs during the business continuity period, other than 1 or more major changes that are permitted under subsection (5); and
 - (d) subsection (3) does not apply to prevent the tax loss component being carried forward to the tax year.

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