EXPOSURE DRAFT - FOR COMMENT AND DISCUSSION ONLY

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Notes: This draft item does not consider the interpretation of the targeted anti-avoidance provisions relating to the business continuity test in s IB 3 due to the significant overlap with the current revision of the s BG 1 interpretation statement.

INTERPRETATION STATEMENT

Loss carry-forward – continuity of business activities

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This interpretation statement provides guidance on how the main aspects of the business continuity test in s IB 3 of the Income Tax Act 2007 apply. The business continuity test may enable a company to carry forward tax losses despite a breach in ownership continuity if certain requirements are satisfied.

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

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Summary

1. This interpretation statement provides guidance on how the main aspects of the business continuity test in s IB 3 apply. The key points discussed in the Interpretation Statement are summarised as follows:.

   - The main rule in s IB 3 provides that a tax loss may be carried forward despite an ownership continuity breach if no major change in the nature of the business activities carried on by the company occurs during the business continuity period, unless the change is a permitted major change (s IB 3(2)(c)).
   - Section IB 3 sets out various other criteria that must also be satisfied. Further, targeted anti-avoidance rules in ss GB 3BAB and GB 3BAC can negate the benefit of a tax loss carried forward under s IB 3 in prescribed circumstances.

- An ownership continuity breach for a company means a breach in the requirements for continuity of ownership set out in s IA 5, that, if met, enable tax losses of the company to be carried forward (s IB 2).
- The business continuity period is typically the period starting immediately before the ownership continuity breach and ending on the earlier of:
  - the last day of the income year in which the tax loss component in question is used; and
  - the last day of the income year in which the fifth anniversary of the ownership continuity breach falls.

  However, broadly, for a company where 50% or more of its tax losses eligible for carry-forward arose from bad debt deductions, the business continuity period will end on the last day of the income year in which the tax loss component in question is used. In other words, the five-year cap on the test will not apply (s IB 4).
- Companies that form part of the same group of companies immediately before and immediately after an ownership breach occurs (for each of the companies) are treated as a single company for the purposes of the business continuity test (and its associated avoidance provisions) (s IB 5).
- The main rule in s IB 3(2)(c) is concerned with the nature of the company's business activities. "Business activities" are any action taken in pursuit of one or more businesses that may be carried on by the company for income tax purposes. "Nature" is defined as "the basic or inherent features, qualities, or character of a person or thing", so the test is concerned with the basic or inherent features, qualities, or character of the company's business activities.
- The nature of a company's business activities should be described by referring to the type (or category) of product or service that the company produces or provides, and not to particular products or services.
- Determining whether there has been a major change in the nature of a company's business activities requires both a qualitative and a quantitative assessment, taking into account changes in assets and any other potentially relevant factors. Overall, the relevant factors to be taken into account and their weight will depend on the particular facts in question. The change will be major if it is of greater importance when comparing the nature of the company's business activities before and after the ownership continuity breach.
- The extent to which the assets used in deriving the company's assessable income have remained the same or similar over the continuity period is a factor to be

taken into account in determining whether a major change has occurred (s IB 3(4)).

- The relevant assets of a company will usually be those recorded in its statement of financial position. However, depending on the particular facts, other assets may also be taken into account, such as internally generated goodwill, brands, customer lists, and early-stage intangibles, but not people, generic business processes, or generic know-how.
- Certain assets may be more relevant to the question of whether or not there has been a major change than other assets.
- Section IB 3(4) requires an assessment of the extent to which the assets used in deriving the company's assessable income have remained the same or similar over the business continuity period. The assets of a company may need to be replaced due to wear and tear, obsolescence, or to keep up with new improvements. Provided the replacement assets are of the same kind in appearance, character, and quantity as the assets they are replacing (without being identical), the change in those assets is not a factor that is taken into account in assessing whether there has been a major change.
- Section IB 3(4) does not limit the factors that may be taken into account. Other factors that may be relevant include changes in:
    - business processes;
    - suppliers or other inputs;
    - scale;
    - the markets supplied to; and
    - the type of product or service produced or provided.
- If there has been a major change in the business activities carried on by a company, the business continuity test may still be satisfied if the major change is a permitted major change (s IB 3(5)). There are four permitted major changes, broadly, changes:
    - made to increase the efficiency of a business activity;
    - made to keep up to date with advances in technology;
    - caused by an increase in the scale of a business activity; and
    - caused by a change in the type of products or services produced or provided.
- Depending on the facts, it may be easier to first consider whether a change in the nature of the business activities carried on by a company is a permitted major

change (on the assumption that the change is major). If the change falls within one or more of the permitted major changes, it will be unnecessary to determine whether the change is a major change.

- Changes caused by a change in the type of products or services a company produces or provides will be a permitted major change if the change involves starting to produce or provide a product or service:
    - using the same, or mainly the same, assets as; or
    - that is otherwise closely connected with,

  a product or service that the company produced or provided immediately before the start of the continuity period (s IB 3(5)(d)).
- The first limb of s IB 3(5)(d) can be satisfied where the "same, or mainly the same" assets are used to produce or provide the new type of product or service. On balance, it is considered that an interpretation of mainly that numerically equates to approximately 75% is appropriate in this context.
- For the purposes of the second limb of s IB 3(5)(d), the connection between the new product or service and existing products or services needs to be strong. Examples could include products or services:
    - based on the same underlying technology; or
    - that significantly enhance the utility or enjoyment of existing products or services.
- A tax loss cannot be carried forward if before the beginning of the business continuity period the business activities carried on by the company have ceased and have not been revived (s IB 3(3)(a)), or if the company ceases to carry on business activities during the business continuity period (s IB 3(2)(b)).
- For the purposes of ss IB 3(3)(a) and IB 3(2)(b), a temporary cessation will not constitute a cessation of business activities. In contrast, cessation with the possibility of recommencement will constitute a cessation.

Introduction

2. Companies can carry forward unused tax losses to the next tax year under subpart IA only if they satisfy certain ownership continuity requirements. However, from the 2020/21 income year, companies that do not meet those requirements may still be able to carry forward unused tax losses under a new test in subpart IB (the business continuity test).

3. The business continuity test broadly applies where no major change in the nature of the business activities carried on by the company occurs during the relevant business continuity period, subject to various conditions.

4. This statement sets out how the Commissioner will interpret the main aspects of the business continuity test.

Business continuity test

What is the purpose of the test?

5. The purpose of subpart IB (which includes the business continuity test) and its associated anti-avoidance measures is set out in s IB 1:

> **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.

What is the main rule?

6. The main rule of the business continuity test is set out in s IB 3(2)(c):

> **IB 3 When tax loss components of companies carried forward despite ownership continuity breach**
>
> …
>
> *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—
>
> …
>
> (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
>
> …

7. The main rule is that a tax loss may be carried forward despite an ownership continuity breach if no major change in the nature of the business activities carried on by the company occurs during the business continuity period, unless the change is a permitted major change.

8. The aspects of the main rule discussed below are:

- the meaning of "ownership continuity breach" (at [14]);
- the meaning of "business continuity period" (at [16]);
- how the rule applies to groups of companies (at [21]);
- how to determine the nature of a company's business activities (from [23]);
- how to determine whether there has been a major change in the nature of a company's business activities (from [34]); and
- permitted major changes (from [66]).

What are the other requirements?

9. In addition to the main rule, several other requirements must be satisfied before a tax loss can be carried forward under s IB 3. These requirements are that:

- an ownership continuity breach must have occurred (during the 2020/21 income year or later) (s IB 3(1));
- the tax loss being carried forward must have arisen in the 2013/14 income year or later (s IB 3(2)(a));

- the company does not cease to carry on business activities during the business continuity period (s IB 3(2)(b));
- the company did not cease to carry on business activities before the beginning of the business continuity period or, if it did, the business activities were revived before the beginning of the business continuity period (s IB 3(3)(a));
- for tax losses arising from the 2020/21 income year or a later income year, another ownership continuity breach has not occurred from (and including) the income year in which the tax loss arose and in relation to which either the cessation rule in s IB 3(2)(b) or the major change rule in s IB 3(2)(c) was not satisfied (s IB 3(3)(b));
- for tax losses arising before the 2020/21 income year, an ownership continuity breach did not occur from (and including) the income year in which the tax loss arose to the 2019/20 income year (s IB 3(3)(c)); and
- the anti-avoidance rule in s GB 3BA does not apply (s IB 3(6)).

10. In addition, s IB 3 does not apply to companies that are mineral miners (see s IS 2).

11. Finally, targeted anti-avoidance rules in ss GB 3BAB and GB 3BAC can negate the benefit of a tax loss carried forward under s IB 3 in prescribed circumstances.

12. Except for the cessation rules in s IB 3(2)(b) and 3(3)(a) (which are discussed from [88]), these other requirements and targeted anti-avoidance rules are not discussed in this interpretation statement.

13. Appendix One contains a flow chart that can be used to help determine whether a tax loss component of a company can be carried forward from an income year under s IB 3 despite an ownership continuity breach.

What is an ownership continuity breach?

14. An ownership continuity breach is defined in s IB 2:

> **IB 2 Meaning of ownership continuity breach**
>
> In this subpart, an **ownership continuity breach**, for a company, means a breach of the requirements for continuity of ownership of section IA 5 (Restrictions on companies' loss balances carried forward: continuity of ownership) that, if met, enable a tax loss component of the company to be carried forward in a loss balance

15. An ownership continuity breach for a company means a breach of the requirements for continuity of ownership set out in s IA 5, that, if met, enable tax losses of the company

to be carried forward. Under s IA 5, tax losses can broadly be carried forward provided a group of persons holds at least 49% of the voting interests in a company over the relevant continuity period. The interpretation and application of s IA 5 is outside the scope of this item.

What is the business continuity period?

16. The business continuity period is defined in s IB 4:

> **IB 4 Business continuity period**
>
> *Period*
>
> (1) The period referred to in section IB 3(2)(b), for an ownership continuity breach and a tax loss component of a company, is the period beginning immediately before the ownership continuity breach occurs and ending on,—
>
> (a) for a company for which the amount calculated using the formula in subsection (2) is 0.50 or greater, the last day of the income year that corresponds to the tax year in which the company uses the tax loss component; or
>
> (b) in any other case, the earlier of—
>
> (i) the last day of the income year that corresponds to the tax year in which the company uses the tax loss component; and
>
> (ii) the last day of the income year in which the fifth anniversary of the ownership continuity breach falls.
>
> *Formula*
>
> (2) The formula is—
>
> (bad debt deductions – bad debt repayment income) ÷ (total deductions – bad debt repayment income).
>
> *Definition of items in formula*
>
> (3) In the formula,—
>
> (a) **bad debt deductions** is the total amount of deductions that the company has been allowed under section DB 31(3) (Bad debts) for income years between the 2013–14 income year and the income year corresponding to the tax year immediately preceding the ownership continuity breach, both income years inclusive, in which a tax loss component included in the company's tax loss for that tax year arose:
>
> (b) **bad debt repayment income** is the total amount of income that the company has under section CG 3 (Bad debt repayment)—

> (i) for income years between the earliest and the latest of the income years described in paragraph (a), both income years inclusive; and
>
> (ii) that relates to deductions that the company has been allowed under section DB 31(3):
>
> (c) **total deductions** is the total amount of deductions that the company has been allowed for the income years described in paragraph (a).

17. In summary, the business continuity period is typically the period starting immediately before the ownership continuity breach and ending on the earlier of the last day of the income year in which the:
    - tax loss component in question is used; or
    - fifth anniversary of the ownership continuity breach falls.

18. However, broadly, for a company where 50% or more of its tax losses eligible for carry-forward arose from bad debt deductions, the business continuity period will end on the last day of the income year in which the tax loss component in question is used. In other words, the five-year cap on the test will not apply.

19. For a tax loss component to be carried forward, no major change in the nature of the business activities carried on by the company must occur **during** the business continuity period (s IB 3(2)(c)). This requires a comparison between the business activities the company carried on immediately before the ownership continuity breach and the business activities the company carried on at all times thereafter until the last day of the income year in which the company uses the tax loss component in question (subject to the five-year cap on the test, if applicable).

20. Because the test in s IB 3(2)(c) is concerned only with the tax loss component to be carried forward, losses previously carried forward under the test and used in an earlier income year are not jeopardised by a subsequent major change in the nature of the business activities the company carries on.

How does the rule apply to groups of companies?

21. Section IB 5 sets out how the business continuity test applies to groups of companies:

> **IB 5 When group companies treated as single company**
>
> Companies that are part of the same group of companies immediately before and immediately after an ownership continuity breach occurs for each of the companies are treated as a single

> company for the purposes of this subpart and sections GB 3BA to GB 3BAC (which relate to arrangements involving tax losses).

22. Companies that form part of the same group of companies immediately before and immediately after an ownership breach occurs (for each of the companies) are treated as a single company for the purposes of the business continuity test (and its associated avoidance provisions) (s IB 5).

What is the nature of a company's business activities?

23. "Business activities" is not a defined term. "Business" is defined in s YA 1 as including any profession, trade, or undertaking carried on for profit. The Court of Appeal interpreted the term in *Grieve v CIR* [1984] 1 NZLR 101 (CA) as requiring a two-fold inquiry: an enquiry as to the nature of the activities carried on and an inquiry as to the intention of the taxpayer in engaging in those activities.

24. "Activity" is defined in the *Concise Oxford English Dictionary* (12th ed, New York, Oxford University Press) as "an action taken in pursuit of an objective".

25. It follows that "business activities" are any action taken in pursuit of one or more businesses that the company may carry on for income tax purposes.

26. This interpretation is consistent with the commentary to the Supplementary Order Paper to the Taxation (Annual Rates for 2020-21, Feasibility Expenditure, and Remedial Matters) Bill (the Commentary), which refers to the particular actions carried out by the business to generate income and the processes or methods by which they are carried out. The Commentary explains that the term "business activities" was used to ensure that the test is not applied granularly on a business-by-business basis.

27. The rule is concerned with the nature of the company's business activities. "Nature" is defined in the *Concise Oxford English Dictionary* as "the basic or inherent features, qualities, or character of a person or thing", so the rule is concerned with the basic or inherent features, qualities, or character of the company's business activities.

28. Differing levels of granularity can be used to describe the nature of a company's business activities. For example, business activities can be described:

    - very broadly (for example, agriculture, manufacturing, construction, retail, or professional services);
    - more narrowly (for example, sheep farming, clothing manufacturing, house construction, book retailing, or architectural services); or

- very narrowly by reference to a particular product or service (for example, merino sheep farming for fine wool, hosiery manufacturing, kitset house construction, children's book retailing or residential architecture).

An important issue in applying the business continuity test is the appropriate level of granularity.

29. In interpreting any provision, regard must be had to both the text of the provision and its purpose: s 5 of the Interpretation Act 1999. Where the meaning of a provision is not clear the courts will have regard to context and purpose as essential guides to meaning: *Commerce Commission v Fonterra Co-operative Group Ltd* [2007] NZSC 36, at [22] to [24].

30. Specified purposes of the business continuity test include promoting innovation, economic growth, and resilience. A less granular description of business activities is consistent with this. However, another purpose is not to encourage tax avoidance arrangements involving share acquisitions (that is, loss trading), so the description should not be so broad as to encourage such arrangements.

31. The permitted major change in s IB 3(5)(d) (see from [78]) is relevant context for this purpose. Section IB 3(5)(d) provides that a change in the **type** of products or services a company produces or provides is a permitted major change.

32. "Type" is defined in the *Concise Oxford English Dictionary* as a category of things having common characteristics. The reference to a type of product or service in s IB 3(5)(d) suggests Parliament anticipated that changes in the type of products or services a company produces or provides could give rise to a major change in a company's business activities. It also implies that changes of particular products within a type or category should not give rise to a major change.

33. It follows that the nature of a company's business activities should be described by referring to the type (or category) of product or service that the company produces or provides, but not to particular products or services (ie, neither very broadly nor very narrowly). For example, see the descriptions in the second bullet point at [28].

What is a major change in the nature of those activities?

34. "Major" is defined in the *Concise Oxford English Dictionary* as "important, serious, or significant. ▪ greater or more important; main".

35. The meaning of "major change" was considered in a similar context by the Northern Ireland Court of Appeal in *Willis (H.M. Inspector of Taxes) v Peeters Picture Frames Ltd* [1983] STC 453. This case concerned s 483(1)(a) of the UK Income and Corporation Taxes Act 1970, which prevented the carry-forward of tax losses if there was both a

change in ownership of a company and a "major change in the nature or conduct of a trade carried on by the company".

36. Gibson LJ said (at 460):

> In construing the phrase "major change in the conduct of the trade", I would deal with it in two parts. **Whether there has been a change in the conduct of the trade clearly imports a qualitative test, because one is looking for a different type of conduct**. Where the difference in conduct is claimed to be a difference in the manner of the disposal of the company's goods, it is clearly not sufficient to satisfy the definition if there is merely a change in the number or identity of customers or outlets, or if the proportion of goods distributed through each is changed. **But in judging whether the change is major, a different criterion should be applied. The obvious contrast is between changes which are major and those which are minor; that is to say, it is a question of degree, or a quantitative matter. I would ask the question: is the change of greater or lesser importance when considering the company's method of trading?** The Special Commissioners posed the question whether there had been a significant change. Insofar as there may be changes of major or minor significance, they were perhaps putting the question too favourably to the Crown; though I think they were probably using the word 'significant' as meaning of greater than little significance.
>
> [emphasis added]

37. In summary, Gibson LJ said that whether a major change has occurred in the conduct of a trade is qualitative, as to whether there has been a change, and quantitative, as to whether the change is major – the latter being a question of degree, with major meaning "of greater importance".

38. Lowry LCJ, in the same decision, similarly said that the primary meaning of major was "greater" as in the "major part" (at 462).

39. Although foreign case law is not binding on New Zealand courts, it is considered this decision would be influential given the common subject-matter.

40. This meaning is also consistent with the Commentary, which suggests that whether a change in business activities is a major change is generally a question of scale: in other words, the significance of the change in the context of the operations of the entire company.

41. Continuity of assets is a factor that must be taken into account in determining whether a major change in the nature of the business activities of the company has occurred (s IB 3(4); and see from [44]). But the legislation does not otherwise limit or specify the factors that may be taken into account. Other potentially relevant factors are discussed from [63].

42. In summary, determining whether there has been a major change in the nature of a company's business activities requires both a qualitative and a quantitative assessment, taking into account changes in assets and any other potentially relevant factors.

43. Overall, the relevant factors to be taken into account and their weight depend on the facts in question. The change will be major if it is of greater importance when comparing the nature of the company's business activities before and after the ownership continuity breach.

Assets factor

44. Section IB 3(4) provides:

> **IB 3 When tax loss components of companies carried forward despite ownership continuity breach**
>
> …
>
> *Major change: factor that must be taken into account*
>
> (4) For the purposes of subsection (2), without limiting the factors that may be taken into account in determining whether a major change in the nature of the business activities carried on by the company has occurred during the business continuity period, the extent to which the assets used in deriving the company's assessable income have remained the same or similar over the business continuity period must be taken into account
>
> …

45. The extent to which the assets used in deriving the company's assessable income have remained the same or similar over the continuity period is a factor to be taken into account in determining whether a major change has occurred.

46. "Assets" are not defined in the Act for the purposes of s IB 3(4). "Asset" is defined in the *Concise English Oxford Dictionary* as including both "a useful or valuable thing or person" and "property owned by a company and regarded as having value and being available to meet its commitments".

47. For accounting purposes, an "asset" is broadly defined as a right that is controlled by the entity and that has the potential to produce economic benefits.[1] However, certain rights do not satisfy the accounting definition, including:

- the economic benefit of employee services;

[1] See XRB, *New Zealand Equivalent to the* IASB Conceptual Framework for Financial Reporting (issued May 2018 and incorporating amendments to 31 January 2019, Wellington, External Reporting Board) (2018 *NZ Conceptual Framework*), from [4.3].

- internally generated goodwill and brands and customer lists; and
- internally generated intangible assets that do not satisfy recognition criteria (broadly, research and early development stage intangibles).[2]

48. In interpreting the meaning of "assets" in s IB 3(5), regard must be had to both the text of the provision and its purpose: s 5 of the Interpretation Act 1999. As discussed earlier, the purposes of subpart IB include promoting innovation, growth, and resilience, but not encouraging tax avoidance arrangements (that is, loss trading).

49. An interpretation of "assets" strictly based on accounting definitions and standards may not be consistent with the purposes of promoting innovation, growth and resilience. This is because assets that are not recognised in a company's accounts could be important to a company achieving those purposes. Conversely, a very broad interpretation of assets that includes people and items such as generic business processes or generic know-how could encourage loss trading. This is because people with transferable skills can easily be engaged in different business activities, and, similarly, generic business processes and know-how can easily be applied to different business activities.

50. Practically, the Commissioner considers that the relevant assets of a company will usually be those recorded in its statement of financial position. However, depending on the particular facts, other assets may also be taken into account, such as internally generated goodwill, brands, customer lists and early-stage intangibles, but not people, generic business processes, or generic know-how.

51. A further requirement of s IB 3(4) is that the assets to be taken into account are those that are **used** in deriving the company's assessable income over the business continuity period. These assets will typically be all current and non-current assets of a company, including trading stock, working capital, and passive investments. However, any assets of a company that are not used in deriving assessable income over the business continuity period must be excluded from the determination. For example, a company may own bare land for the purpose of future expansion that is not currently being used or may own plant or machinery that has been mothballed but not disposed of.

52. Changes in assets can be assessed by comparing new assets to assets that have remained the same or similar over the business continuity period. This comparison could be based on the:

[2] See 2018 *NZ Conceptual Framework* at [4.8] and XRB, *New Zealand Equivalent to* International Accounting Standard 38 Intangible Assets (issued November 2004 and incorporating amendments to 31 January 2021, Wellington, External Reporting Board) (NZ IAS 38), at [48], [54], [57] and [63].

- numbers of different types of asset;
- value of different types of asset (historic cost, book value, replacement value or market value); or
- area or floorspace occupied by different types of asset.

53. The most appropriate way of assessing changes in assets will depend on the context, and should seek to avoid distortions. For example, assessing changes by reference to the book value of assets may be distortionary where assets have been significantly depreciated in a company's accounts. In such cases, replacement value or market value might give a more accurate picture.

54. In some instances it may be helpful (or necessary) to value an asset for the purposes of applying the test. For example, a material asset may not be recognised in a company's financial statements (see at [50]), or the market value of a material asset may otherwise be appropriate. In such cases, a commercially orthodox valuation methodology should be used.

55. Certain assets may be more relevant to the question of whether there has been a major change than other assets, or may otherwise create distortions. For example:
    - key business assets such as manufacturing plant or intellectual property will be more important than generic office premises and equipment;
    - working capital is generic so will be of little relevance; and
    - attributing weight to a holding company's investments in its subsidiaries where a group of companies is treated as a single company under s IB 5 is likely to be distortionary.

Same or similar assets

56. Section IB 3(4) requires an assessment of the extent to which the assets used in deriving the company's assessable income have remained the same or similar over the business continuity period.

57. The reference to "remained" requires a comparison between the assets the company used immediately before the ownership continuity breach and the assets the company used over the rest of the business continuity period.

58. "Similar" in the *Concise Oxford English Dictionary* includes "of the same kind in appearance, character, or quantity, without being identical."

59. The Commentary suggests that the reference to same or similar assets is to clarify that the normal replacement of assets should not be part of the assessment of whether a major change has occurred.

60. The assets of a company may need to be replaced due to wear and tear, obsolescence or to keep up with new improvements. Provided the replacement assets are of the same kind in appearance, character, and quantity as the assets they are replacing (without being identical), the change in those assets is not a factor that is taken into account in assessing whether a major change has occurred.

61. The assets of a company may also need to be replaced or supplemented when its business activities are increasing in scale. For example, existing assets may be replaced with significantly larger assets, or supplemented with significantly more assets of the same kind. It is considered that these replacement or supplemental assets would not be "similar" in character or quantity respectively to the existing assets for the purposes of s IB 3(4).

62. This interpretation is supported by the permitted major change for increases in scale (see from [76]), which implies that a significant increase in the size or number of existing assets is a factor that could give rise to a major change. If asset acquisitions of this kind contribute to a major change in the nature of the company's business activities, the permitted major change relating to increases in scale may be relevant.

Example 1 – Same or similar assets

Single Track Cycles Ltd operates a mountain bike retailing and repair business from its own premises. The company has tax losses carried forward from recent years, and recently had an ownership continuity breach when a key employee took a majority stake in the company.

The premises are by far the company's most valuable asset, but are proving to be too small due to increasing customer demand.

The company jumps on an opportunity to acquire a much larger premises nearby (over double the floor-area), and sells its existing premises to part-fund that acquisition.

The company's directors are concerned that the high dollar-value of the transaction may give rise to a major change in the nature of its business.

Because the new premises are significantly larger than the previous premises, they are not "similar" to the previous premises for the purposes of s IB 3(4). Accordingly, the change in premises must be taken into account in assessing whether a major change in the nature of the company's business activities has occurred.

While the scale of the company's business activities is likely to increase, all of the other factors have effectively remained the same. It follows that the acquisition of the new premises will not give rise to a major change in the nature of the company's business activities. Even if it did, the permitted major change for increases in scale would apply.

Other factors that may be taken into account

63. Section IB 3(4) does not limit the factors that may be taken into account. As context, the permitted major changes in s IB 3(5) indicate additional factors that may be relevant (given that s IB 3(5) applies only once a major change has been identified). In particular:

    - the efficiency and technology permitted major changes (discussed from [70] and from [74], respectively) suggest that changes in business processes and suppliers or other inputs may be relevant;
    - the scale permitted major change (discussed from [76]) suggests that changes in scale and the markets supplied to may be relevant;
    - the type of product or service permitted major change (discussed from [78]) suggests that changes in the type of product or service produced or provided may be relevant.

    These additional factors are consistent with the other potentially relevant factors identified in the Commentary.

64. In terms of "other inputs", changes in the people involved in a business may be a relevant factor, depending on the context. For example, significant changes in the number or skills of employees in a service-related business could be indicative of a major change.

65. As with the assets factor, these other factors may be measured in different ways. Again, it will depend on the context as to which measurement method is most appropriate in any given fact situation. The primary question is whether there has been a major change in the nature of the business activities carried on by the company compared with the nature of the business activities carried on immediately before the ownership continuity breach.

Example 2 – Reduced scale

Facts

Bun Factor Ltd carries on a business of baking mass-produced plain loaves of white bread in its own fully-automated bakery premises. The loaves are sold to supermarkets in the surrounding region. However, due to the low margins on plain white bread, Bun Factor Ltd has suffered trading losses in recent years.

The sole shareholder and chief executive of the company, George, decides to shift the company's focus to baking artisanal sour-dough loaves using wood-fired ovens and organic flour made from heirloom wheat varieties. George hopes this will return the company to profitability as the margins for artisanal bread are much higher than for mass-produced bread, even though the volume of output will be significantly reduced.

As George does not have experience in this type of baking, he brings in a new majority shareholder, Alexandra, who is a renowned artisan baker. This breaches ownership continuity.

To enable the change in product, Bun Factor Ltd removes and sells off its automated bread production line, installs wood-fired ovens and acquires the new plant and equipment required for artisanal bread-making. The company also hires additional staff as the new process is more labour intensive. Bun Factor Ltd changes its name to Hippy Dough Ltd and begins supplying its sour-dough loaves to high-end organic supermarkets, restaurants and cafés.

Analysis

Before the ownership continuity breach, the business activity of Bun Factor Ltd was bread bakery operation. The issue is whether the significant decrease in output has given rise to a major change in the nature of that business activity that is not a permitted major change.

The land and building, office and IT equipment, delivery vehicles and some bread-making equipment continue to be used after the change.

The new wood-fired ovens and bread-making plant and equipment are similar to (that is, of the same character as) the automated bread production line that they replaced. Despite the change in baking process, the fundamental steps in making bread remain the same. The new equipment enables those steps to be carried out manually, whereas previously they were automated.

It follows that all the assets the company uses after the breach in deriving its assessable income have remained the same or similar.

The company's business processes have not changed. Hippy Dough Ltd still bakes loaves of bread and sells them to retailers, despite the baking process changing from automated mass-production to artisanal.

The company's main supplier has changed. Hippy Dough Ltd now sources its flour from a boutique flour mill. Despite this, the input is essentially the same – flour. A like for like substitution of suppliers is not indicative of a change in the nature of business activities. The only relevant changes in this respect are the hiring of a specialist artisanal baker and an increase in staff numbers because of the more labour-intensive production process.

The scale of output has changed significantly. Previously, Bun Factor Ltd produced 2,000 loaves of plain white bread per day. In contrast, Hippy Dough Ltd now produces 500 artisanal sour-dough loaves a day. However, the reduction in scale is largely countered by the improvement in quality. It follows that the reduction in scale is not indicative of a major change in the nature of the company's business activities in this instance.

The **type** of product the company sells has not changed. Previously, the company produced and sold loaves of bread, which it continues to do after the ownership continuity breach.

Based on the above, the company has not had a major change in the nature of its business activities, despite the significant reduction in its output of loaves.

For completeness, none of the permitted major changes would be applicable on these facts. The change was not made to increase efficiency, was not made to keep up to date with advances in technology, was not caused by an increase in the scale of a business activity, and was not caused by a change in the type of product produced by the company.

What are the permitted major changes?

66. If a major change in the business activities carried on by a company has occurred, the business continuity test may still be satisfied if the major change is a permitted major change. Section IB 3(5) and (7) provide:

> **IB 3 When tax loss components of companies carried forward despite ownership continuity breach**
>
> …
>
> *Permitted major changes*

> (5) A major change in the nature of the business activities carried on by the company during the business continuity period does not breach the requirement set out in subsection (2)(c) if the major change is—
>
> (a) made to increase the efficiency of a business activity carried on by the company:
>
> (b) made to keep up to date with advances in technology:
>
> (c) caused by an increase in the scale of a business activity carried on by the company, including as a result of the company entering a new market for a product or service that it produces or provides:
>
> (d) caused by a change in the type of products or services the company produces or provides that involves the company starting to produce or provide a product or service using the same, or mainly the same, assets as, or that is otherwise closely connected with, a product or service that the company produced or provided immediately before the beginning of the business continuity period.
>
> …
>
> *A definition*
>
> (7) In subsection (5), **asset** does not include land other than buildings and fixtures.

67. The four permitted major changes set out in s IB 3(5) are, broadly, changes:

- made to increase the efficiency of a business activity;
- made to keep up to date with advances in technology;
- caused by an increase in the scale of a business activity; and
- caused by a change in the type of products or services produced or provided.

68. The Commentary states that the permitted major changes are intended to permit loss carry-forward in spite of a major change where the changes:

- are a consequence of natural development that could have happened absent the change in ownership;
- are about a company being able to position its resources in a way that maximises returns; and
- are driven by genuine commercial reasons and are not related to the availability of tax losses.

69. Depending on the facts, it may be easier to first consider whether a change in the nature of the business activities a company carries on is a permitted major change (on the assumption that the change is major). If the change falls within one or more of the permitted major changes, it will be unnecessary to determine whether the change is in fact a major change.

Changes to increase efficiency

70. Major changes that are made to increase the efficiency of a business activity carried on by a company are permitted under s IB 3(5)(a). "Efficiency" is defined in the *Oxford Concise English Dictionary* as the state or quality of being efficient, and "efficient", in turn, is defined as working productively with minimum wasted effort or expense.

71. The efficiency of an existing business activity can be increased by maintaining the same level of output with reduced costs, or by increasing the level of output without increasing costs. Changes made to increase efficiency will typically involve changes to business processes, assets utilised, suppliers, or other inputs.

72. Increased costs or investment may be incurred in the short term in order to achieve cost savings in the medium to long term. For example, a company might invest in expensive new plant that performs an existing function more efficiently. Such a change (if it contributed to a major change) would be a change made to increase efficiency.

73. The business activity that benefits from the increase in efficiency must be an existing business activity of the company. As discussed at [30], for the purposes of s IB 3(2)(c), business activities should be described by reference to a type of product or service. A change to a different type of product that is either cheaper to produce or more profitable is not increasing the efficiency of an existing activity. Such a change (if it is major) should be considered under the permitted major change relating to products and services (see from [78]).

Example 3 – Outsourcing a manufacturing operation

Expeditions Unlimited Ltd designs and manufactures high-quality outdoor equipment in it own local factory. The company supplies this equipment to domestic and international wholesalers. However, due to stiff competition from large northern hemisphere manufacturers, the company has suffered losses.

A majority stake in the company is sold to a new investor, which breaches ownership continuity. The new owner insists the local factory be closed and the manufacturing outsourced in order to reduce costs.

A company in Vietnam can manufacture the goods to the required standard, and all manufacturing is outsourced to that company. The design of the goods continues to be done in New Zealand, and the branding of the goods remains the same. The completed goods are shipped direct to the wholesalers from Vietnam.

Expeditions Unlimited Ltd is concerned about the impact of outsourcing on its ability to carry forward its losses, given the significant change in business processes and assets because of the closure of its local factory.

Before the ownership continuity breach, the nature of Expeditions Unlimited Ltd's business activity was manufacturing outdoor equipment. The issue is whether the significant changes in business processes and assets have given rise to a major change in the nature of that activity that is not a permitted major change.

Even if the outsourcing gave rise to a major change in the nature of the company's business activities, the major change would be a permitted major change under s IB 3(5)(a), as it is made to increase the efficiency of the manufacturing operation carried on by the company. Accordingly, the company will satisfy the business continuity test in s IB 3(2)(c), and it is not necessary to determine whether a major change has occurred.

Changes to keep up to date with advances in technology

74. Major changes that are made to keep up to date with advances in technology are permitted under s IA 3(5)(b). Logically, the technology advance must be related to the company's existing business activities (for example, where new technology enables greater output of an existing product or service).

75. In contrast, changes to producing or providing a type of product or service based on an emerging technology that is unrelated to a company's existing business activities would not fall within this permitted major change.

Example 4 – Technology advances

Sustainable Delivery Ltd (SDL) is a courier company that uses a fleet of electric vehicles (EVs) to transport parcels between its major depots in an environmentally sustainable way. However, SDL has incurred losses in its early years, due in part to the high wage cost of its drivers.

Driverless vehicle technology makes rapid advances and becomes authorised for commercial use in New Zealand.

SDL undertakes a large capital-raise to enable it to acquire a fleet of driverless EVs (at significant cost). The capital-raise breaches SDL's ownership continuity. SDL is concerned that the replacement of its entire fleet of vehicles (its main asset) may jeopardise its ability to carry forward its losses.

The change in SDLs assets is made to keep up with driverless vehicle technology, so any resulting change in the nature of its business (if that change were a major change) would be a permitted major change under s IB 3(5)(b). Therefore, it is unnecessary for SDL to consider whether any change in the nature of its business activities is major under s IB 3(2)(c).

Increases in scale

76. Major changes caused by an increase in the scale of a business activity a company carries on are permitted under s IB 3(5)(c). This includes increases in scale because the company is entering a new market for a product or service that it produces or provides. Again, this test is concerned with an increase in scale of an existing business activity of the company.

77. Examples of new markets for these purposes could be new geographical or demographical markets, or retail compared with wholesale markets.

Changes in the type of products or services produced or provided

78. Changes caused by a change in the type of products or services a company produces or provides will be a permitted major change, if the change involves starting to produce or provide a product or service:

    - using the same, or mainly the same, assets as; or
    - that is otherwise closely connected with,

    a product or service that the company produced or provided immediately before the start of the continuity period (s IB 3(5)(d)).

79. The Commentary states that this permitted major change allows a company to:

    - pivot and drop a type of product or service and start producing or supplying another that has a close connection; and
    - be able to retain its existing product or service but also add to it as opportunities arise, as long as there is a close connection.

80. For the purposes of this permitted major change, assets do not include land other than buildings and fixtures (s IB 3(7)). "Land" is defined in s YA 1 as including any estate or interest in land, so land for these purposes will include both freehold and leasehold estates.

81. A "type" of product or service is a category of things having common characteristics, as discussed at [32].

82. The first limb of this permitted major change can be satisfied where the "same, or mainly the same" assets are used to produce or provide the new type of product or service. "Mainly" is defined in the *Concise Oxford English Dictionary* as meaning more than anything else, and for the most part. In this instance, "mainly" is used in conjunction with "same", so its meaning must be considered in that context.

83. The meaning of "mainly" when used in conjunction with "wholly" is considered in detail in "IS 18/05 Income tax: donee organisations – meaning of wholly or mainly applying funds to specified purposes within New Zealand", *Tax Information Bulletin* Vol 30, No 10 (November 2018): 25. In summary, where the word mainly appears in conjunction with wholly, it is capable of meaning (in numerical terms) anything from 51% to 99%, depending on context and the purpose of the relevant provision (see IS 18/05 at [100] to [101]). It is considered that this will similarly be the case where "mainly" is used in conjunction with "same".

84. The purposes of promoting growth, innovation, and resilience support an interpretation of mainly that is numerically closer to 51% than 99%, as this would enable companies to achieve those purposes more easily. However, in terms of context, the second limb to this permitted major change requires an **otherwise close** connection (see from [86]), which implies a more restricted interpretation of mainly. On balance, it is considered that an interpretation that equates (in numerical terms) to approximately 75% is appropriate in this context.

85. There are a number of ways that assets could be measured for this purpose (see the discussion at [51] and [53]). The most appropriate way will depend on the context, and should seek to avoid distortions. Again, particular assets may be more relevant than others, depending on the context (as discussed at [55]).

86. In terms of the second limb to this permitted major change, "closely connected" is not defined in the Act. "Close" in the *Concise Oxford English Dictionary* in the context of a connection means strong. "Connected" is defined in the *Concise Oxford English Dictionary* as including joined or linked together.

87. It follows that the connection between the new product or service and existing products or services needs to be strong. Examples could include products or services:

- based on the same underlying technology; or
- that significantly enhance the utility or enjoyment of existing products or services.

Example 5 – Diversifying a "bricks and mortar" business

Facts

Derek is the sole shareholder of Book Worm Ltd, which operates a bookstore from leased premises. The store has a small but dedicated customer-base. The company's assets recognised in its accounts are its fit-out of the store (largely consisting of shelving and display stands), a considerable amount of trading stock (that is, books), and some IT and office equipment. The fixed assets have a very low book value due to depreciation. No goodwill is reflected in the accounts.

Due to competition from online book sellers, the company has suffered losses. Disillusioned with book retailing, Derek sells the company to Rachel, breaching ownership continuity.

Under Rachel's ownership, Book Worm Ltd refreshes the decor and installs a café counter from which coffee and pastries are sold. This involves considerable expenditure on the counter, a work bench, tables and chairs, a coffee machine and other appliances, crockery, and glassware. Rachel hires a part-time barista to run the café counter.

Rachel hopes the café counter will generate additional income from the sale of coffee and pastries, and will also increase book sales by attracting additional customers and keeping them in the store longer.

The café counter is very successful, with coffee and pastry sales soon constituting approximately 70% of the company's income. Book sales increase slightly, but that side of the business remains loss-making. Despite this, Book Worm Ltd continues to sell books as this gives the store its identity.

Analysis

Before the ownership continuity breach, the business activity of Book Worm Ltd was book retailing. The issue is whether the introduction of the café counter has given rise to a major change in the nature of the business activities that is not a permitted major change.

All the existing assets of the business (including the considerable trading stock of books) continue to be used in the new business.

However, new assets are now also used in deriving the company's assessable income (that is, the café counter, work bench, tables and chairs, coffee machine, other appliances, crockery,, and glassware). The cost of these new assets is roughly equal to the combined value of the trading stock and the existing fixed assets (measured at book value). However, if the existing fixed assets were valued at replacement value, the ratio of new assets to existing assets would be about one-quarter.

Any goodwill that existed before the changes continues to be used, but its value and impact are arguably low.

Business processes have changed to an extent – while the company still retails books, a proportionately larger amount of time is spent operating the café side of the business.

Suppliers and other inputs have changed to an extent. Shop overhead and book suppliers remain the same, but there are new suppliers for the café side of the business, and a significant volume of transactions goes through those new suppliers. A new part-time staff member has also been dedicated to the café business.

Scale and markets supplied to (local retail customers) have not changed.

The type of product the company sells has changed to an extent. Previously, the company sold books. Now, the company sells predominantly coffee, as well as books.

Major means of greater importance in this context. By value, approximately 75% of the assets of the business have remained the same or similar through the change (using replacement value to prevent distortions). Overall, the continuity of assets does not suggest a major change. However, business processes, suppliers and other inputs, and the type of product provided have all changed significantly, because coffee sales now represent 70% of the company's income.

Weighing up all the factors, on balance, it is considered a major change in the nature of the business activities of the company has occurred. Accordingly, it is necessary to consider whether the major change is a permitted major change.

The only potentially relevant permitted major change relates to a change in the type of products or services produced or provided (s IB 3(5)(d)). The issue is whether the provision of coffee uses the same or mainly the same assets as the provision of books, or is otherwise closely connected with the provision of books.

The IT and office equipment continue to be used for the provision of coffee. On balance, it is arguable that the bookshop fitout (ie, shelving and display stands) and trading stock of books also continue to be used for the provision of coffee, as they both contribute to the backdrop and atmosphere of the café, and customers read the books while enjoying their coffee. By value, these assets equate to approximately 75% of the assets that were previously used for the provision of books. Accordingly, it is considered that the provision of coffee uses mainly the same assets as were previously used for the provision of books. Therefore, the major change is a permitted major change, and s IB 3(2)(c) is satisfied.

For completeness, it is not considered that coffee is otherwise **closely** connected to books. While the inclusion of cafés in retail stores is relatively common practice, the café enhances the shopping experience rather than the product being bought. Coffee does not have a strong relationship with books.

Additional facts

The following year, Rachel decides that selling books is not worth the effort and that profitability would be increased if the entire shop were dedicated to selling coffee and pastries. The shelving, display stands, and trading stock of books are sold, and bookshelf wallpaper is hung as a nod to the shop's past. Additional café assets are acquired to fill the larger area and enable the company to expand the food on offer.

Before the ownership continuity breach, the business activity of Book Worm Ltd was book retailing. Again, the issue is whether a major change in the nature of that business activity has occurred that is not a permitted major change.

As the facts are more extreme than before, it follows that there will have been a major change in the nature of the business activities carried on by the company. The key issue is whether that major change is a permitted major change.

The only common assets are now the office and IT equipment. These will equate to significantly less than half of the assets previously used in the book retailing business activity. Accordingly, the café business does not use mainly the same assets as were previously used for the provision of books.

Further, it is considered that coffee is not closely connected to books for the reasons discussed above. It follows that the company cannot carry forward any of the remaining unused losses that arose prior the ownership continuity breach.

Example 6 – Diversifying a "people-intensive" business

Facts

Judy, a registered real estate agent, is the sole owner of Property Insights Ltd, through which she provides commercial real estate agency services with the help of a part-time assistant. She is highly regarded for her knowledge and contacts in the commercial property world. However, the company recently sustained losses due to the impacts of COVID-19 on the business.

The company leases furnished office premises and a car, and has a small amount of office equipment (including Judy's laptop and mobile phone).

To diversify the business and create opportunities for cross-selling, Judy convinces an acquaintance, Alan, an established commercial property manager, to join the company with his team of four assistants. As part of the deal, Alan takes a 60% stake in the company, breaching ownership continuity.

The company continues to operate from its existing premises, with the staff hot-desking when they are in the office. New laptops, mobile phones, and leased cars are acquired for Alan and his team. Alan brings most of his existing clients with him, and his side of the business quickly accounts for about 60% of the company's income .

Analysis

Before the ownership continuity breach, the nature of the company's business activities was the provision of real estate agency services. The issue is whether the introduction of the property management activities has given rise to a major change that is not a permitted major change.

The company's assets largely consist of generic office equipment (that is, laptops, mobile phones and other office equipment). While there have been some changes in those assets, the changes are not given significant weight due to their generic nature.

The key assets of the business after the ownership continuity breach are the existing goodwill from Judy's know-how, clients and contacts in the commercial property world, together with the goodwill that Alan brings to the company in the form of his existing know-how, client list and contacts. The fact Alan's side of the business quickly generates 60% of the company's income suggests there is heavy reliance on his goodwill following the ownership continuity breach, which in turn suggests a significant change in the assets the company uses in deriving its assessable income.

The business processes involved in providing real estate agency services and property management services are largely the same (that is, both involve the provision of intermediary-type services for a fee), and suppliers remain the same. But personnel has significantly changed to enable the company to provide the property management services – in particular, the engagement of a new principal and four assistants all of whom are dedicated to the new business activity.

Neither the scale of existing activities nor the markets supplied to (that is, commercial property buyers/owners) has changed.

The type of service provided has changed. Previously the company provided real estate agency services, whereas after Alan and his team joined it provides property management services as well, which accounts for about 60% of the company's income.

In summary, both the key assets the company uses in deriving its assessable income and the type of service the company provides have had an approximate 60% change, and personnel has significantly changed to enable this. The business processes, suppliers, scale of existing activities, and markets supplied to have not changed.

It is considered that the changes in key assets, type of service provided and personnel mean a major change in the nature of the company's business activities has occurred. Real estate services of the kind the company provided are heavily people-dependent, so the changes in goodwill and personnel are particularly important.

The only potentially relevant permitted major change is the one relating to changes in the type of product or service produced or provided. The first issue is whether the provision of both real estate agency services and property management services uses the same or mainly the same assets as the provision of solely real estate agency services.

As discussed above, the key asset (that is, goodwill) the company uses in deriving its assessable income has significantly changed. It follows that the provision of property management services does not use the same or mainly the same assets as the provision of real estate agency services. Although the laptops and phones acquired for Alan and his team are also new, again, continuity of generic business assets is given little weight in this context.

The next issue is whether property management services are otherwise closely connected with real estate agency services. It is considered that they would be, because they enhance the utility of the real estate agency services. This is supported by the fact one of the reasons Judy brought Alan into the company was to create cross-selling opportunities.

It follows that Property Insights Ltd will satisfy the business continuity test in s IB 3, so the losses incurred before Alan and his team joined the company will be available to offset against income of the company after the ownership continuity breach.

Additional facts

The following year, Judy and Alan fall out over the direction of the business. Around the same time, Judy gets an offer to join a competitor's agency, so leaves the company, selling her remaining shares to Alan. Alan continues to provide property management services (but not real estate agency services) through the company with his team of assistants.

The further sale of shares by Judy to Allan does not give rise to an ownership continuity breach. Property Insights Ltd will continue to satisfy the business continuity test in s IB 3 after Judy exits the company, because the provision of property management services is closely connected to the real estate agency services that the company provided immediately before the ownership continuity breach.

Example 7 – Failing the test

Facts

Sunshine Holiday Camp Ltd owns a camping ground in a prime beach-front location. The company is family owned and run. The company provides a range of accommodation to holiday-makers from luxury serviced cabins to campervan and tent-sites. The camping ground has considerable infrastructure, including an office block, various types of cabins, shared cooking and ablution blocks, a laundry and a recycling station.

Unfortunately, a lack of up-keep of the camping ground, together with competition from online bach-booking platforms, has led to significant losses in recent years.

The family is aware that the value of the land has risen significantly, so decides the time is right to wind up the camping ground business and subdivide and sell the land as residential sections. The capital value of the land for rating purposes is $6m, with improvements of $2m.

The company is asset-rich but cash poor, and the family has no experience in property development. Accordingly, it decides to bring in an outside investor with experience in major subdivisions to both fund and carry out the development. This breaches ownership continuity.

The company sells off what camping-ground assets it can and demolishes remaining structures. The site is contoured and divided into 25 sections, complete with roadways, drainage and services. The company markets the sections and disposes of them for a significant profit.

Analysis

Before the ownership continuity breach, the nature of the company's business activities was camping ground operation. The issue is whether the change to its business activities is a major change that is not a permitted major change.

In terms of assets, the land continues to be used by the business in deriving its income (although the amount of land decreases as sections are sold). The value of the land significantly outweighs the value of the camping ground assets that are disposed of.

Suppliers and other inputs have changed considerably, as have business processes, the markets supplied to, and the type of service or product produced or provided.

Despite the continued use of the land, the other factors all strongly suggest a major change in the nature of the business activities.

None of the permitted major changes will apply in this instance. In particular, the permitted major change relating to changes in the type of product or service produced or provided using the same or mainly the same assets will not be satisfied as land is excluded from the determination.

Accordingly, the losses incurred before the ownership continuity breach will not be able to be carried forward and set off against the profits from the land development activity under s IB 3.

What are the cessation rules?

88. A tax loss cannot be carried forward if, before the beginning of the business continuity period, the business activities company carries on have ceased and not been revived (s IB 3(3)(a)). In addition, a tax loss cannot be carried forward if the company ceases to carry on business activities during the business continuity period (s IB 3(2)(b)).

89. The Commissioner considers that existing case law on the cessation of a business for income tax purposes is relevant in this context.

When have business activities ceased?

90. Whether a business has ceased is a question of fact. A taxpayer will cease to be in business when it no longer has the intention to make a profit from the activities carried on (see *AAA Developments (Ormiston) Ltd v CIR* (2015) 27 NZTC 22-026 (HC), *Case F31* (1983) 6 NZTC 59,712 (TRA), *Case G8* (1985) 7 NZTC 1,021 (TRA) and *Case J2* (1987) 9 NZTC 1,004 (TRA)).

91. Gendall J in *AAA Developments (Ormiston)* stated at [48]:

> At the outset I need to say that, as I see the position, the TRA [Taxation Review Authority] was correct in finding that the business of AAA ceased from 24 July 2008. AAA was incorporated for one reason, and one reason alone. That was to develop the Land. From the moment AAA attempted to accept Ormiston's otherwise invalid cancellation of the purchase agreement, it is difficult to accept AAA's argument that it still maintained some profit making intention from this point in time forward. Of course, in assessing this criterion it is necessary to have regard to statements made by a taxpayer. However, the ultimate analysis requires an assessment of a taxpayer's intention gleaned from all relevant circumstances. ...

92. Generally, a business will cease when it ceases trading. However, in *Case* U29 (2000) 19 NZTC 9,273 (TRA), Judge Barber held that the particular facts of the case need to be

examined to ascertain whether a business terminated when trading ceased. Judge Barber stated at [51]:

> It now seems to me that the tidying-up of the affairs of a business could often mean the continuance of the business for income tax purposes for a reasonable period beyond cessation of trading, but one needs to examine the particular facts of the case to ascertain whether or not the business terminated when trading ceased.

93. *Case L89* (1989) 11 NZTC 1,508 (TRA) concerned a taxpayer's purchase of a hotel business in April 1983. Soon after settlement the hotel business ran into difficulties, and the taxpayer made a claim against the vendor for misrepresentation. The assets of the business were ultimately sold by receivers in October 1983. The taxpayer argued that the business continued after the sale of the assets due to the ongoing litigation against the vendor and the collection of outstanding trade debts. Judge Barber stated at 1,511:

> by the beginning of the 1985 income tax year there was no business activity taking place on behalf of the objector company. True, the recovery of debts and tidying up of the affairs of a business can be of such a degree as to amount to a continuation of the previous trading business, but not usually. That issue must always be one of fact and degree in any particular case. Here, there was very little such activity in 1985 and 1986. I do not accept as a general proposition that, for income tax purposes, a business continues so long as it has debts which result from that business.

94. In summary, Judge Barber considered that the recovery of debts and tidying up of the affairs of a business could be of such a degree as to amount to a continuation of the previous trading business. However, he considered that this would not usually be the case and would always be a question of fact and degree.

95. The ultimate failure of an activity will not of itself indicate the non-existence of a business (*McGrath v CIR* (1987) 9 NZTC 6,074 (HC) and *Slater v CIR* (1996) 17 NZTC 12,453 (HC)).

What is temporary cessation?

96. When applying the tests in *Grieve v CIR* [1984] 1 NZLR 101 (CA), the courts draw a distinction between a "temporary cessation of business" (where the business activities have temporarily ceased or been suspended but will recommence) and "cessation with the possibility of recommencement" (where business activities have ceased, and it is not certain that the business activities will recommence). In the former case, the business continues to exist despite the temporary cessation, whereas in the latter case, there is a cessation of the business.

97. The distinction between temporary cessation and cessation with the possibility of recommencement is considered in detail in "QWBA 21/**XX** Income tax and GST –

deductions where businesses have been disrupted by the COVID-19 pandemic", *Tax Information Bulletin* Vol XX, No X (2021): XX.

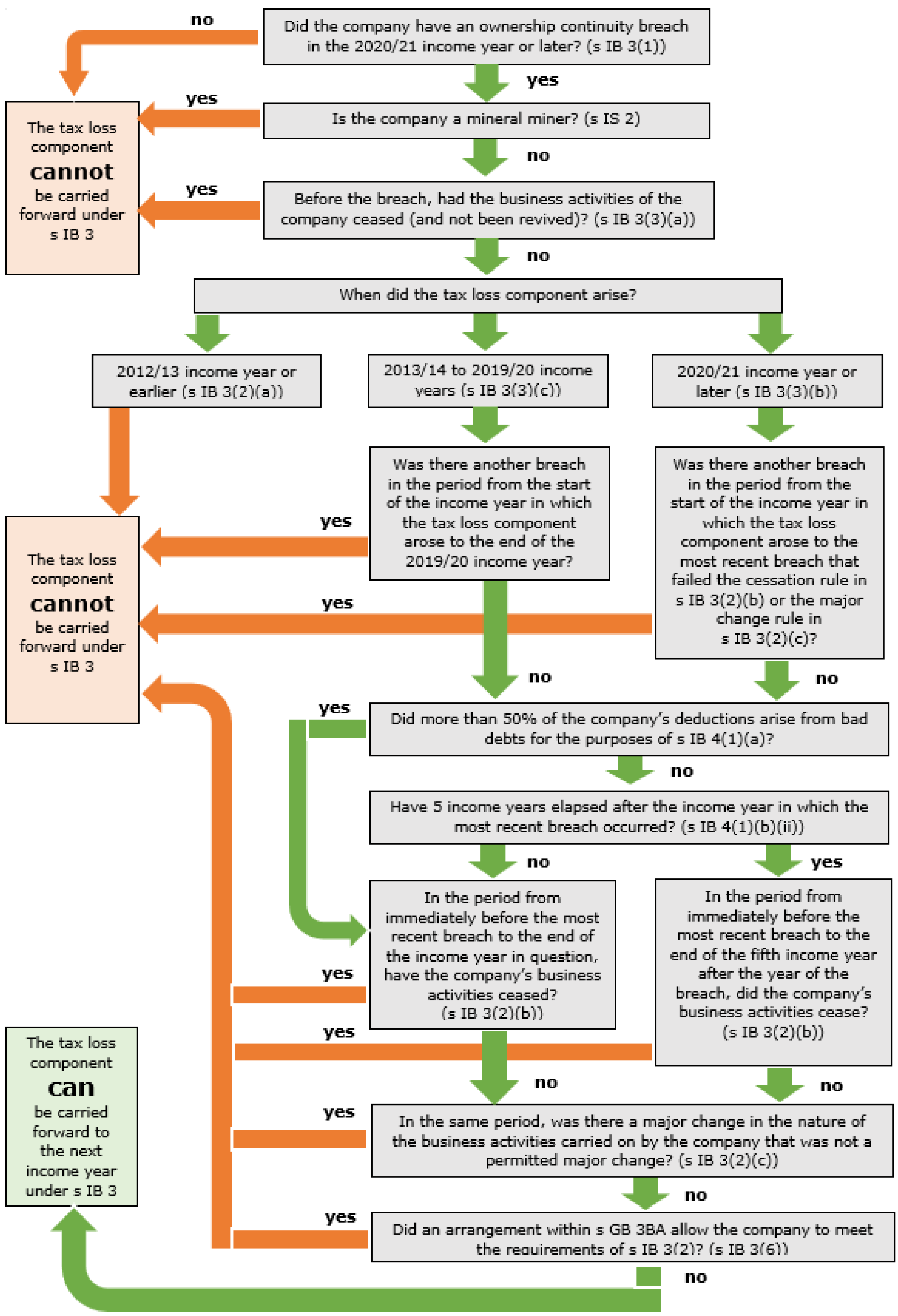
98. For the purposes of s IB 3(3)(a) and IB 3(2)(b), a temporary cessation will **not** constitute a cessation of business activities. In contrast, cessation with the possibility of recommencement will constitute a cessation.

Have the business activities been revived?

99. "Revived" in the *Concise Oxford English Dictionary* includes restored to life. For a company's business activities to be revived, it would need to satisfy the business test in *Grieve* again (see above at [23]).

Appendix One: Flow chart

Use this flow chart to help determine whether a tax loss component of a company can be carried forward from an income year under s IB 3 despite an ownership continuity breach.



Appendix Two: Legislation

100. Sections IB 1 to IB 5 are as follows:

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 2 Meaning of ownership continuity breach

In this subpart, an **ownership continuity breach**, for a company, means a breach of the requirements for continuity of ownership of section IA 5 (Restrictions on companies' loss balances carried forward: continuity of ownership) that, if met, enable a tax loss component of the company to be carried forward in a loss balance

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.

Tax loss components for earlier income years not carried forward

(3) The tax loss component is not carried forward to the tax year if—

(a) before the beginning of the business continuity period,—

(i) the business activities carried on by the company have ceased; and

(ii) the business activities have not been revived:

(b) the earlier income year is the 2020–21 income year or a later income year and the company has had another ownership continuity breach—

(i) since the beginning of the earlier income year; and

(ii) in relation to which the requirements of subsection (2)(b) and (c) for the carrying forward to the tax year of the tax loss component are not met:

(c) the earlier income year is before the 2020–21 income year and an ownership continuity breach occurred for the company in the period—

(i) beginning on the first day of the earlier income year; and

(ii) ending on the last day of the 2019–20 income year.

Major change: factor that must be taken into account

(4) For the purposes of subsection (2), without limiting the factors that may be taken into account in determining whether a major change in the nature of the business activities carried on by the company has occurred during the business continuity period, the extent to which the assets used in deriving the company's assessable income have remained the same or similar over the business continuity period must be taken into account

Permitted major changes

(5) A major change in the nature of the business activities carried on by the company during the business continuity period does not breach the requirement set out in subsection (2)(c) if the major change is—

(a) made to increase the efficiency of a business activity carried on by the company:

(b) made to keep up to date with advances in technology:

(c) caused by an increase in the scale of a business activity carried on by the company, including as a result of the company entering a new market for a product or service that it produces or provides:

(d) caused by a change in the type of products or services the company produces or provides that involves the company starting to produce or provide a product or service using the same, or mainly the same, assets as, or that is otherwise closely connected with, a product or service that the company produced or provided immediately before the beginning of the business continuity period.

Avoidance arrangements

(6) Section GB 3BA (Arrangements for carrying forward loss balances: companies' business activities) may apply to treat a company as not meeting the requirements of subsection (2).

A definition

(7) In subsection (5), **asset** does not include land other than buildings and fixtures.

IB 4 Business continuity period

Period

(1) The period referred to in section IB 3(2)(b), for an ownership continuity breach and a tax loss component of a company, is the period beginning immediately before the ownership continuity breach occurs and ending on,—

(a) for a company for which the amount calculated using the formula in subsection (2) is 0.50 or greater, the last day of the income year that corresponds to the tax year in which the company uses the tax loss component; or

(b) in any other case, the earlier of—

(i) the last day of the income year that corresponds to the tax year in which the company uses the tax loss component; and

(ii) the last day of the income year in which the fifth anniversary of the ownership continuity breach falls.

Formula

(2) The formula is—

(bad debt deductions – bad debt repayment income) ÷ (total deductions – bad debt repayment income).

Definition of items in formula

(3) In the formula,—

(a) **bad debt deductions** is the total amount of deductions that the company has been allowed under section DB 31(3) (Bad debts) for income years between the 2013–14 income year and the income year corresponding to the tax year immediately preceding the ownership continuity breach, both income years inclusive, in which a tax loss component included in the company's tax loss for that tax year arose:

(b) **bad debt repayment income** is the total amount of income that the company has under section CG 3 (Bad debt repayment)—

(i) for income years between the earliest and the latest of the income years described in paragraph (a), both income years inclusive; and

(ii) that relates to deductions that the company has been allowed under section DB 31(3):

(c) **total deductions** is the total amount of deductions that the company has been allowed for the income years described in paragraph (a).

IB 5 When group companies treated as single company

Companies that are part of the same group of companies immediately before and immediately after an ownership continuity breach occurs for each of the companies are treated as a single company for the purposes of this subpart and sections GB 3BA to GB 3BAC (which relate to arrangements involving tax losses).

Draft items produced by the Tax Counsel Office represent the preliminary, though considered, views of the Commissioner of Inland Revenue.

In draft form these items may not be relied on by taxation officers, taxpayers, and practitioners. Only finalised items represent authoritative statements by Inland Revenue of its stance on the particular issues covered.

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About this document

Interpretation statements set out the Commissioner's view of the taxation laws for specific situations when a binding public ruling is not appropriate.