

## INTERPRETATION STATEMENT

# Income tax and GST – deductions for businesses disrupted by the COVID-19 pandemic

Issued: 29 June 2021

IS 21/04

## Scope of this statement

This Interpretation Statement considers whether a business can claim an income tax deduction for expenditure or loss incurred where the business has downscaled or stopped operating because of the COVID-19 pandemic. This statement also briefly considers the GST implications of these events.

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

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## Summary

1. Many businesses have faced significant disruption because of the COVID-19 pandemic. Some businesses have had to downscale or temporarily suspend their operations. Others have had to close completely. However, expenses and losses may still be incurred while the business is not operating. Whether a business has ceased operating temporarily or permanently has implications for whether it can claim income tax deductions for any expenditure or loss incurred.
2. An income tax deduction will usually be allowed where a business has downscaled or ceased operating temporarily, provided the general permission is satisfied (s DA 1) and the deduction is not disallowed by one of the general limitations such as the capital or private limitation (s DA 2). A deduction will usually be disallowed where a business has completely ceased, even if it is possible that the business may restart later.
3. Whether a business has ceased operating temporarily or permanently is a question of fact in each case. The nature of the activities carried on and the business's intention in engaging in those activities are relevant considerations.

4. Similar questions may arise for businesses in a GST context. If a registered person ceases to carry on a taxable activity they may be required to deregister from GST. If a person is deregistered for GST, because they have ceased to carry on a taxable activity or because they have chosen to deregister (perhaps because they do not expect to make taxable supplies exceeding \$60,000 in the next 12 months), then they must make a deregistration adjustment and will be unable to claim any further input tax deductions.
5. For most taxpayers, determining whether their business activities have ceased temporarily or permanently will be straightforward. It will usually be obvious by the time a tax return is filed whether a business exists or not. However, if a business has ceased, it will be important to identify when this occurred because any expenditure or loss incurred after this point is unlikely to be deductible.
6. Examples are included from [63] to explain how the law applies.

## Introduction

7. Many businesses have faced significant disruption because of the COVID-19 pandemic. For example, the tourism sector has faced disruption because border restrictions have prevented international tourists from entering New Zealand. Disruption has occurred in many other sectors as well.
8. Businesses have responded in different ways to this disruption. Some businesses have temporarily ceased or suspended their operations. Many businesses, such as restaurants and cafes, were unable to trade during Alert Level 4,<sup>1</sup> so had no option but to temporarily cease or suspend their operations. Other businesses permanently ceased operating; perhaps because they relied on international tourists. The Commissioner understands that some tourism businesses have ceased operating but hope to restart once the New Zealand borders open again.
9. In both scenarios, businesses may continue to incur expenses. The issue addressed in this Interpretation Statement is whether those expenses or losses are deductible when the business derives little or no income.

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<sup>1</sup> For more information on New Zealand's alert levels, see [COVID-19 Alert System](#) (website, New Zealand Government, 2020).

## Analysis

### Deductibility

10. Section DA 1 contains the general rule allowing deductions. This is known as the general permission:

#### DA 1 General permission

##### *Nexus with income*

- (1) A person is allowed a deduction for an amount of expenditure or loss, including an amount of depreciation loss, to the extent to which the expenditure or loss is—
- (a) incurred by them in deriving—
    - (i) their assessable income; or
    - (ii) their excluded income; or
    - (iii) a combination of their assessable income and excluded income; or
  - (b) incurred by them in the course of carrying on a business for the purpose of deriving—
    - (i) their assessable income; or
    - (ii) their excluded income; or
    - (iii) a combination of their assessable income and excluded income.

##### *General permission*

- (2) Subsection (1) is called the **general permission**.

11. A person is allowed a deduction for an amount of expenditure or loss to the extent that it is incurred<sup>2</sup> by them in deriving their assessable income, or in the course of carrying on a business for the purpose of deriving their income. These are sometimes referred to as the first and second limbs of s DA 1.
12. Businesses usually claim deductions under the second limb of s DA 1. The second limb allows deductions for business expenditure or loss and is considered broader than the first limb (*Europa Oil (NZ) Ltd v CIR (No 2)* (1974) 1 NZTC 61,169 (CA)).

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<sup>2</sup> In the context of s DA 1, the word "incurred" has been held to mean that the taxpayer must have paid or become "definitively committed" to the expenditure or loss (*FCT v James Flood* (1953) 88 CLR 492 (HCA) and *CIR v Mitsubishi Motors NZ Ltd* (1995) 17 NZTC 12,351 (PC)).

13. Under the second limb, the expenditure or loss must be incurred “in the course of carrying on a business”. Therefore, a sufficient relationship (or nexus) must exist between the expenditure and the business that is being carried on for the expenditure or loss to be deductible (*CIR v Banks* (1978) 3 NZTC 61,236 (CA) and *Buckley & Young Ltd v CIR* (1978) 3 NZTC 61,271 (CA)).
14. Whether a business is being “carried on” is the main inquiry in this Interpretation Statement.
15. For completeness, note that even if a deduction is allowed under s DA 1, it may still be disallowed under s DA 2 if one of the general limitations applies, such as the capital or private limitation. In addition, the expenditure or loss may need to be apportioned between deductible and non-deductible amounts.
16. The principles of deductibility under s DA 1 are discussed in Interpretation Statement “[IS 14/04](#): Income tax — Deductibility of company administration costs”, *Tax Information Bulletin* Vol 26, No 7 (August 2014): 5, at [26]–[28].

## Carrying on a business

17. In the context of this Interpretation Statement, it is assumed that before 21 March 2020 (before the lockdown period),<sup>3</sup> a business was being carried on for the purpose of deriving income and deductions were available for any expenditure or loss incurred. The issue is whether, from 21 March 2020, a business was still being carried on, so that any expenditure or loss incurred continues to be deductible.
18. “Business” is defined broadly in s YA 1 as including “any profession, trade, or undertaking carried on for profit”.
19. The leading case on what constitutes a business is *Grieve v CIR* (1984) 6 NZTC 61,682 (CA). *Grieve* concerned a farming activity that, ultimately, did not generate any profits. The issue was whether the taxpayers were carrying on a farming business so they could claim deductions for losses incurred. The Court of Appeal held that whether a taxpayer is in business involves a two-fold inquiry as to the:
  - nature of the activities carried on; and
  - intention of the taxpayer in engaging in those activities.
20. In the leading judgment, Richardson J identified several factors relevant to determining whether a taxpayer is carrying on a business. These factors are the:

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<sup>3</sup> On 21 March 2020, the alert level system was introduced in New Zealand. The whole of New Zealand was initially placed at Alert Level 2.

- nature of the activity;
- period over which the activity is engaged in;
- scale of operations and the volume of transactions;
- commitment of time, money and effort;
- pattern of activity; and
- financial results.

21. Richardson J also stated that it might be helpful to consider whether the operations involved are characteristic of that kind of business. However, ultimately, it is the character and circumstances of the particular venture that are crucial, at 61,691:

It may be helpful to consider whether the operations involved are of the same kind and are carried on in the same way as those which are characteristic of ordinary trade in the line of business in which the venture was conducted. However, in the end it is the character and circumstances of the particular venture which are crucial. Businesses do not cease to be businesses because they are carried on idiosyncratically or inefficiently or unprofitably, or because the taxpayer derives personal satisfaction from the venture.

22. Therefore, whether a business exists is a question of fact in each case. The *Grieve* test is discussed in more detail below.

### **Intention to make a profit**

23. It is the taxpayer's subjective intention to make a profit that is relevant, although this must be objectively assessed.

24. A reasonable prospect of profit is not necessary. An actual intention, once established, is sufficient. However, if, realistically, there seems no real prospect of profit, then the taxpayer's claim that they genuinely intended to carry on a business for profit may be viewed circumspectly. Richardson J, in *Grieve*, stated (at 61,691) that while a taxpayer's statements as to their intentions are relevant, "actions will often speak louder than words".

25. A taxpayer will cease to be in business when it no longer has the intention to make a profit from the activities carried on (*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)).

26. 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.

[Footnote omitted]

27. However, an intention to make a profit is not enough to establish that a business is being carried on. A business cannot exist simply in the mind of a taxpayer (*Calkin v CIR* (1984) 6 NZTC 61,781 (CA)). The nature of the activities carried on also need to be considered.

### **Nature of the activities carried on**

28. The nature of the activities carried on must be sufficient to support the concept of a business (*Case L19* (1989) 11 NZTC 1,125 (TRA) and *Case H63* (1986) 8 NZTC 460 (TRA)). The factors Richardson J identified in *Grieve* (at [20]) may assist with this inquiry.
29. In *Slater v CIR* (1996) 17 NZTC 12,453 (HC), Fisher J explained that the taxpayer must engage in an operational activity that is relevant for the type of business that is being undertaken, at 12,460:

The taxpayer must embark on the actual course of conduct which it is hoped would ultimately yield profit if persisted in. I do not think that merely setting up a business structure and purchasing plant or organising the decision-making structures, management and equity structures will suffice. That is not "carrying on a business" but "setting up a business". Nor do I think that activities which are confined to the organisation of relationships between proprietors, or the making of decisions over their future ownership of the business, would normally qualify because they are non-productive of income. As I understand it there must be an operational activity. Other matters may well be pre-conditions to operational activity but will not suffice in themselves.

30. However, it is not necessary for a taxpayer to be actually trading or earning assessable income for deductions to be available. This is because the nature of a taxpayer's business may necessarily require expenditure and negotiations leading to contracts and to earning income (*Case M68* (1990) 12 NZTC 2,384 (TRA)).
31. 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.

32. However, in *Case L89* (1989) 11 NZTC 1,508 (TRA), Judge Barber considered that this would not usually be the case and it would always be a question of fact.

## Determining whether a business has ceased

33. If a business has completely ceased, it is generally unable to claim income tax deductions for any expenditure or loss incurred after cessation.<sup>4</sup> Therefore, it is important to determine whether, in fact, a business has completely ceased.
34. When applying the tests in *Grieve*, the courts have drawn 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). Deductions are usually allowed for “temporary cessation” but not for “cessation with the possibility of recommencement”.
35. This distinction was explained in *Case F73* (1983) 6 NZTC 59,931 (TRA). The taxpayer company was a partner in a fishing venture. In 1979, the skipper resigned and the boat stopped being used for fishing, although the partners continued to look for a new skipper. In 1980, the boat was removed from the water to reduce overheads and sale became a possibility. The boat was sold a year later. The taxpayer claimed a deduction for expenses incurred in the 1981 income year, arguing that at this stage, there was merely a temporary cessation of the fishing venture. They relied on attempts (that came to nothing) to set up share fishing or leasing arrangements with the boat.
36. Judge Barber held that by 1981 the business had ceased to operate and the partners were biding their time over the best course of action to take. This was not a temporary cessation, but a cessation with the possibility of recommencement:

The source of income from fishing no longer existed well before 1 April 1980. I consider that there was not merely a temporary cessation of income earning operations in the

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<sup>4</sup> However, there are some specific types of employment-related expenditure that may still be deductible following the cessation of a business – see ss DC 1, DC 2 and DC 10 of the Act.



partnership. **There was a cessation with the possibility of recommencement if a suitable operating structure could be worked out with a third party.**

[Emphasis added]

37. *Case F73* predates *Grieve*, but Judge Barber still considered the nature of the operation and the intention of the taxpayer when deciding the issue. Although the taxpayer retained the main asset (the fishing boat) it was difficult to argue that a business was still operating when the boat was out of the water and had not been used for a long period. In addition, there was no skipper and no licence and the insurance policy for the boat had been changed from offshore to onshore. Judge Barber considered that, while the taxpayer (and the other partners) had explored various options to make a profit, ultimately their intention appeared to have been to sell the boat.
38. *Case F73* referred to a similar decision by the Australian Supreme Court in *Queensland Meat Export Co Ltd v FCT* (1939) 4 ATD 176 (QSC). In this case, a meat works company temporarily closed for three years because of competition from a new abattoir in the area. After three years, the directors, who had intended to resume operations when conditions improved, decided to advertise the works for sale as a going concern. No offer was received, so the company sold the buildings, machinery and plant, but not the freehold land or wharf. The company claimed deductions during this period for expenditure incurred in guarding, insuring, maintaining and otherwise protecting the works. The company had continued its meat works business elsewhere in Queensland. The court held that the cessation of business was merely temporary.
39. In *Case F73*, Judge Barber considered whether the principles in *Queensland Meat* would apply, at 59,936:

...The Queensland company's cessation of its Brisbane works was temporary until 5 July 1934; O's cessation of fishing was permanent from at least June 1980. After 5 July 1934 the Queensland company's plant was held mainly for sale but also for use if conditions improved; there was no reasonable prospect of recommencement of fishing by the partnership as at 1 April 1980 and sale was contemplated at least by June 1980. The Queensland company still operated a similar business at other works and at all times carried on its overall business as one business which "was so treated in its balance sheet"; O's other business activities were not related to fishing and were accounted for separately. Both counsel dwelt on various passages in Douglas J's decision. I do not disagree with the principle of the following extracts from the judgment but they do not assist O in the circumstances of this case (p 493):

I think it is one of the incidents of a business of this kind that competition or other adverse condition may compel the owner to close down portion of its plant for an indefinite period. It is an ordinary business precaution that during such period the works and plant should be maintained so far as possible in good working order,

whether the ultimate result be that they should again be opened or that they should be sold or eventually dismantled. ...

The question whether the cessation of operations is merely of a temporary nature, or is one which has reached the final stage, is difficult to answer. ...

Maintenance for a reasonable time of a plant which is about to be sold appears to me to be an incident of the business and to be an outgoing or loss in the gaining or producing of assessable income ...

If money is so laid out in the hope that income may accrue from this works or plant in future, or to maintain it in proper order for a reasonable time awaiting sale, it is a proper deduction against profits, even though the profits come from another plant.

40. The court in *Queensland Meat* accepted that it may be an ordinary incidence of business to shut down for an indefinite period. However, drawing the line between a temporary cessation and cessation with the possibility of recommencement can be difficult. In *Queensland Meat*, although the company was contemplating a sale, it was still deriving income from other related activities that were part of the wider business. *Queensland Meat* can be contrasted with *Case F73* where the taxpayer had other business activities but they were unconnected to fishing.
41. In *Inglis v FCT* (1980) 80 ATC 4,001 (FCA), the Full Federal Court of Australia took the opposite view. The taxpayers owned a farming business but stopped actively farming after becoming involved in a legal dispute. They restricted their operations on the property and moved away for employment. The movable farm plant and machinery was disposed of and there was no stock on the property nor any income derived from the property for the relevant years. The taxpayers argued that while they had to restrict their expenditure on the business, they intended to resume it in the future. They claimed deductions for expenses relating to those years.
42. The court held that the business was no longer being carried on and disallowed the taxpayers' claim. Brennan J observed that the carrying on of a business was not just a matter of intention, but it was also a matter of activity, at 4,004:

...The carrying on of a business is not a matter merely of intention. It is a matter of activity. Yet the degree of activity which is requisite to the carrying on of a business varies according to the circumstances in which the supposed business is being conducted. Little activity may suffice for carrying on a business which does not call for much activity, as in *Thomas v. F.C. of T.* 72 ATC 4094; 46 A.L.J.R. 397 and in *Ferguson v. F.C. of T.* 79 ATC 4261. It must be remembered that "(b)usiness is not confined to being busy; in many businesses long intervals of inactivity occur" as Lord Sumner observed in *South Behar Ry. Co. Ltd. v. I.R. Commrs.* (1925) A.C. 476 at p. 488.

43. Brennan J stated that even if the intention of the owner was relevant in determining whether a business is merely going through a quiet period or has ceased, an intention to revive a business in the future does not prevent a finding that it has ceased to be carried on. Further, whether a business was being carried on could largely be determined by the extent of activity. Since all farming activities had stopped, it was held that no business was, in fact, being carried out on the taxpayer's property.<sup>5</sup>
44. Ultimately, whether a business has ceased is a question of fact in each case. However, it will be easier to argue a business is being carried on where it is well-established and it has kept its business structure and assets in place. Properly maintaining assets and expending time and effort on a relaunch will also support the argument that a business was continuing despite a hiatus.

## Business disruption and the COVID-19 pandemic

45. Many businesses have faced significant disruption because of the COVID-19 pandemic. They have responded in different ways such as downscaling, temporary suspension or cessation of activities, permanent cessation, or cessation with the possibility of restarting. These responses are discussed next.

### Downscaling a business

46. Some businesses have had to downscale their operations until conditions improve by reducing staff numbers or hours of operation. As long as there is still an intention to make a profit and sufficient operational activity (relevant to that type of business and current market conditions), then it is likely that a business is still being carried on and any expenditure or loss incurred can be deducted.
47. The courts have recognised that an enterprise can downscale without ceasing to be a business. In *Case F131* (1984) 6 NZTC 60,200 (TRA), Judge Barber held that, although the greater part of an enterprise may be sold and the balance continued for a time, it does not mean the owners are no longer in business. (In this case, Judge Barber found, as a matter of fact, that there was no business.)
48. However, there will come a point where the downscaling is to such a degree that it indicates the business has ceased. In *Case J78* (1987) 9 NZTC 1,459 (TRA), an elderly couple decided to reduce the area of their farm from 50 acres to four acres to cut costs and alleviate the physical burden of farming. They also decided to diversify their farming from annual crops to longer-term crops that required less effort. The longer-

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<sup>5</sup> Note that the Australian income tax legislation definition of "business" does not require a profit-making intention, but New Zealand income tax legislation does.

term crops were not readily available, so the couple continued to farm as usual, but only on the four acres. They farmed this way, knowing there would be little chance of a profit, and worked part-time jobs to supplement their income. The couple claimed deductions for business losses over the period. The Commissioner disallowed the claim on the basis that they had not been carrying on a business. Judge Barber agreed with the Commissioner. By farming on a reduced scale and with the knowledge that they would not make a profit, the taxpayers could not be regarded as carrying on a business. They continued to farm the land because their culture frowned upon land lying unused. The small amount of development activity was not enough to change this conclusion.

### **Temporary cessation of business activities**

49. Some businesses have had to stop operating temporarily because of the COVID-19 pandemic. For example, during Alert Level 4, many businesses were required by law to cease trading. For many businesses, this would have been a temporary cessation of business. The business would have had the intention to make a profit, but, due to the lockdown, all business activity had to temporarily cease. The Commissioner considers that any expenditure or loss incurred during Alert Level 4 is likely to be deductible, provided there was still an intention to make a profit.
50. This temporary cessation of activities may have extended beyond Alert Level 4. Many businesses remained closed during Alert Levels 3 and 2. Depending on the business, and provided there was still an intention to make a profit, the Commissioner considers that any expenditure or loss incurred during these alert levels is also likely to be deductible.

### **Permanent cessation of business activities or cessation with the possibility of restarting**

51. Not all businesses that stopped operating during the lockdown period would have done so on a temporary basis. If a business completely ceased trading during this period (for example, it laid-off staff, abandoned a lease, and returned stock), then there is no longer an intention to make a profit, so a business is not being carried on. It is irrelevant that the taxpayer might intend to start up the business later if conditions improve. A future intention to start up the business and to make a profit will not satisfy this test. Expenditure or loss incurred after a business has ceased is generally not deductible (*Case U29*).
52. In some cases, taxpayers may have decided to put their businesses up for sale during the lockdown period or even after it. Whether a business has ceased completely is a

matter of fact. If the business intends to make a profit during this period and there is sufficient operational activity, then it is likely that the business is still being carried on. However, in *Case F31*, Judge Barber held that the taxpayer's intention to make a profit ceased on the date they decided to sell the property on which they carried on business, on the basis that they were no longer trading and had decided to sell.

## GST and business cessation

53. Similar questions may arise for businesses in a GST context where the business has been disrupted because of the COVID-19 pandemic.
54. A person must be registered for GST to claim input tax deductions. The Commissioner can cancel a person's registration if they cease to carry on a taxable activity. In addition, a registered person can ask the Commissioner to cancel their registration if they have ceased to be liable to register (because the expected value of their taxable supplies in the next 12 months is not expected to exceed \$60,000) (s 52 of the Goods and Services Tax Act 1985 (GST Act)).
55. "Carrying on a taxable activity" is a different test to "carrying on a business" in s DA 1. "Taxable activity" is defined in s 6(1) of the GST Act to mean:

### Section 6 Meaning of term taxable activity

- (1) For the purposes of this Act, the term **taxable activity** means—
  - (a) any activity which is carried on continuously or regularly by any person, whether or not for a pecuniary profit, and involves or is intended to involve, in whole or in part, the supply of goods and services to any other person for a consideration; and includes any such activity carried on in the form of a business, trade, manufacture, profession, vocation, association, or club:
  - (b) without limiting the generality of paragraph (a), the activities of any public authority or any local authority or public purpose Crown-controlled company.
- (2) Anything done in connection with the beginning or ending, including a premature ending, of a taxable activity is treated as being carried out in the course or furtherance of the taxable activity.

56. A taxable activity must be carried on "continuously or regularly". To be carried on "continuously", the activity cannot have ceased or been interrupted for any material period (*Wakelin v CIR* (1997) 18 NZTC 13,182 (HC)).
57. Section 6(2) extends the scope of s 6(1), by providing that anything done in connection with the ending of a taxable activity (including the premature ending of a taxable activity) is treated as being carried out in the course or furtherance of the taxable

activity. This is the case, even if the taxable activity has ceased. Section 6(2) deems the taxable activity to have continued for anything done in connection with the ending of the taxable activity. [Example 5](#) illustrates how this provision applies.

58. The COVID-19 pandemic may have resulted in some GST-registered businesses having to downscale or cease their taxable activities. The consequences for this are set out in s 52(1)–(5), (5A) and (7) of the GST Act:

#### Section 52 Cancellation of registration

- (1) Subject to this Act, every registered person who carries on any taxable activity shall cease to be liable to be registered where at any time the Commissioner is satisfied that the value of that person's taxable supplies in the period of 12 months then beginning will be not more than the amount specified for the purposes of section 51(1).
- (2) Every person who, by virtue of subsection (1), ceases to be liable to be registered may request the Commissioner to cancel that person's registration, and if the Commissioner is at any time satisfied, as mentioned in subsection (1), the Commissioner shall cancel that person's registration with effect from the last day of the taxable period during which the Commissioner was so satisfied, or from such other date as may be determined by the Commissioner, and shall notify that person of the date on which the cancellation of the registration takes effect.
- (3) Every registered person who ceases to carry on all taxable activities shall inform the Commissioner of that fact within 21 days of the date of cessation and the Commissioner shall cancel the registration of any such person with effect from the last day of the taxable period during which all such taxable activities ceased, or from such other date as may be determined by the Commissioner:  
  
provided that the Commissioner shall not at any time cancel the registration of any such registered person if there are reasonable grounds for believing that the registered person will carry on any taxable activity at any time within 12 months from that date of cessation.
- (4) Any information provided by a registered person to the Commissioner under subsection (3) must include the date on which the person ceased to carry on all taxable activities and whether or not the person intends to carry on any taxable activity within 12 months from that date.
- (5) Where the Commissioner is satisfied that a registered person is not carrying on a taxable activity the Commissioner may cancel that person's registration with effect from the last day of the taxable period during which the Commissioner was so satisfied, or from such other date as may be determined by the Commissioner, and shall notify that person of the date on which the cancellation of the registration takes effect.
- (5A) Any date determined by the Commissioner for the cancellation of registration under subsection (5) may be retrospective to a date not earlier than—
  - (a) the last day of the taxable period during which taxable activity by the person ceased; or

- (b) the date on which the person was registered under this Act, if the Commissioner is satisfied that the person did not, from that date, carry on any taxable activity.
- (6) *[Repealed]*
- (7) In subsections (5) and (5A), for a non-resident person who is not registered under section 54B, a taxable activity means a taxable activity carried on in New Zealand.

59. If the taxable activity has been downscaled to such an extent that it is not expected to make taxable supplies exceeding \$60,000 in the next 12 months, the registered person can choose to deregister from GST (s 52(1) and (2) of the GST Act).
60. If a registered person is no longer carrying on a taxable activity because of the COVID-19 pandemic, they need to inform the Commissioner within 21 days of cessation. The Commissioner may then cancel that person's GST registration. The Commissioner cannot cancel the person's GST registration if there are reasonable grounds for believing the person will carry on any taxable activity at any time within 12 months from the date of cessation (s 52(3) of the GST Act).
61. On ceasing to be registered for GST, the person must make a deregistration adjustment on the deemed supply of the assets used in their taxable activity (s 5(3) of the GST Act).
62. The Commissioner has issued a statutory variation<sup>6</sup> to provide limited relief for registered persons with a taxable activity of supplying accommodation: "[COV 20/09: Variation to sections 52\(3\) and 52\(4\) of the Goods and Services Tax Act 1985](#)", *Tax Information Bulletin* Vol 32, No 8 (September 2020): 22. The variation only applies to short-stay accommodation suppliers that, between 14 February 2020 and 31 October 2020, switched to making exempt supplies of longer-term residential accommodation, leaving them with no taxable activity. The cessation of the person's taxable activity during this period must have been because of the COVID-19 pandemic. In these circumstances, the Commissioner will not cancel the person's registration if there are reasonable grounds for believing they will carry on any taxable activity at any time within 18 months from the date their taxable activity ceased.

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<sup>6</sup> Under s 6I of the Tax Administration Act 1994.

## Examples

63. The following examples explain the application of the law. They concern the deductibility of expenditure or loss for the 2021 tax year and beyond. The examples assume:
- the taxpayer was carrying on a business before the lockdown period;
  - none of the general limitations in s DA 2 apply;
  - the taxpayer was carrying on a taxable activity before the lockdown period; and
  - the taxpayer was registered for GST.
64. Some of the difficulty in determining what expenditure and losses are deductible in periods when a business has ceased operating is because of the uncertainty created by COVID-19. It is difficult to know when market conditions will improve and when the borders will reopen. However, in most cases, by the time the taxpayer files a tax return they will know whether their business activities have ceased temporarily or permanently. If business activities have ceased permanently, it will be important to identify when this occurred because any expenditure or loss incurred after this date is unlikely to be deductible.

### Example 1 – English language school

#### *Facts*

English Language School Ltd operated a busy language school until the COVID-19 pandemic struck. All enrolled students were from overseas. When New Zealand entered Alert Level 4 (on 25 March 2020), the school had to close, and it remained closed until New Zealand returned to Alert Level 2 (on 13 May 2020).

#### *Alert Levels 3 and 4*

During the lockdown periods at Alert Levels 3 and 4, the school accessed the wage subsidy and continued to pay its staff. It also continued to pay rent, rates, power, water and insurance relating to the school building. During this time, no teaching took place, but the school's two shareholders continued to undertake marketing work and provide pastoral care to students that remained in New Zealand. They also used this time to investigate ways to provide online English language tuition.

At this time, the business has been downscaled. There is an intention to operate once the lockdown period is over. All activities undertaken during this period support this finding. Income tax deductions for expenditure incurred during this period are allowed. The school's GST-registration status does not change.



### *Alert Level 2*

At Alert Level 2, the school opens its doors again but about 90% of its students have left New Zealand. Most students stay in New Zealand for about 11 weeks, so by now most have left and no new students will arrive due to border restrictions. When the wage subsidy ends, all staff are made redundant. The two shareholders continue to teach the 10% of students who remain. They also continue to work on marketing and developing online English language tuition technology.

The business continues to operate and income tax deductions for costs incurred during this period are allowed. While the business has been significantly reduced in size, this does not mean it has ceased. An intention to make a profit still exists (and the exploration of online learning possibilities supports this) and there is enough operational activity to support the finding that a business is being carried on. The school's GST-registration status does not change.

### *Alert Level 1*

By 1 September 2020, all students have returned home and it is clear that online learning is not going to be a viable alternative to classroom learning. The school shuts down. The shareholders are hopeful that once the borders reopen, they will be able to start up again, but there is uncertainty about when this might occur.

Costs are still being incurred. The shareholders terminate the lease on the school building and must make a lease termination payment as a consequence. The school's assets (furniture, computers, books, stationery and so on) are put into storage and the school is charged a monthly fee. Some legal fees are incurred for advice on the redundancies and lease termination.

The Commissioner considers that from 1 September 2020, the business has ceased to operate. There is no longer an intention to make a profit because the school has shut down and is no longer operational. Expenditure incurred beyond this point is not deductible. For GST purposes, the shareholders have been advised to remain GST-registered for a few months to ensure that input tax can be claimed on any costs incurred in winding-up the business (included as part of the taxable activity (s 6(2)). By the end of October, all activities relating to the wind-up have ceased and the shareholders notify the Commissioner under s 52(3) that from 31 October they have ceased to carry on a taxable activity. The Commissioner then cancels the GST registration from 31 October (s 52(5A)(a)) and the shareholders make a deregistration adjustment under s 5(3).

### *Establishment of a new business*

After closing the school, the two shareholders decide to give online learning another try. They set up a new business, Online Home School Ltd. This time they are successful in attracting a small group of international students who are eager to learn English online. They run this business from their home.

Expenditure incurred on this new business is deductible. There is an intention to make a profit and the operational activity is sufficient to support the finding that a business is being carried on. However, because this is a new business, the shareholders are unable to deduct any of the costs that relate to the English language school business such as the monthly storage fees. Online Home School Ltd may need to register for GST if the shareholders expect its turnover will exceed \$60,000 in the next 12 months.

### **Example 2 – Souvenir wholesaler**

#### *Facts*

Magnets & More Ltd is a souvenir wholesale business, supplying New Zealand-themed souvenirs to retailers. Since New Zealand entered Alert Level 4 on 25 March 2020, the company has not made a single sale. Many of the company's retailer customers have closed and none are selling New Zealand-themed souvenirs.

Homer is the director and sole shareholder of Magnets & More. He is close to retirement age and is the company's only employee. The company owns the warehouse where the business is run from, and overheads are low. The company has about \$100,000 of stock on hand and will not order any more for now.

Initially, Homer goes to the warehouse every day. He checks his emails for orders and makes calls to his customers. He keeps the warehouse clean and continues to pay a security guard service to monitor and patrol the building. However, by August 2020, it becomes clear to Homer that the New Zealand borders are likely to be closed for the foreseeable future.

With no other options available and no chance of leasing the warehouse in the current market, Homer decides to change focus. He shuts down his website and moves cities to help look after his grandchildren. He is hopeful that one day he may be able to start up the business again, but for now he will focus on his family.

### *Income Tax*

During the 2021 tax year, the company continues to incur costs, including rates, power, water, security and insurance. Homer wants to know whether any of these costs are deductible.

The Commissioner considers that from August 2020 that Magnets & More has ceased to operate, so any expenditure incurred after this date will not be deductible. The complete lack of any operational activity during this time supports this conclusion. The nature of the company's activities during this period, the volume of transactions, the pattern of activity, the financial results and the commitment of time, money and effort, do not suggest an intention to make a profit.

The fact that Homer has retained the business assets for now (the remaining souvenirs and the building) does not mean that he continues to carry on a business.

### *GST*

For GST purposes, Homer remains GST-registered for a few months to ensure that input tax can be claimed on any costs incurred in winding-up the business (included as part of the taxable activity (s 6(2)). By the end of March 2021, all activities relating to the wind-up have ceased and Homer notifies the Commissioner under s 52(3) that from 31 March he has ceased to carry on a taxable activity. The Commissioner then cancels his GST registration from 31 March (s 52(5A)(a)) and Homer must make a deregistration adjustment under s 5(3).

## **Example 3 – Fashion boutique**

### *Facts*

Angela is a sole trader who owns a fashion boutique in a tourist destination. She designs and hand-makes elaborate, embroidered jackets. The jackets are mainly sold to international tourists who visit the town.

When New Zealand entered Alert Level 4, Angela closed her boutique and put the unsold jackets into a special, climate-controlled storage facility to help preserve them. This facility costs Angela \$50 a month. She gave notice on her lease but still had two months of payments to make. She continued to pay rates, insurance, power and water during this time.

During Alert Level 4 and later at Alert Level 3, Angela continued to work on her business from home. She set up an online boutique. However, over the next few months she failed to sell any of her jackets online, so she decided to diversify her business. She starts making cheaper, less elaborate clothing for the domestic market. She also picks up a contract to make uniforms for a local school. She decides to stop making embroidered jackets.

#### *Income Tax*

The Commissioner considers that while Angela's business operations temporarily ceased during Alert Levels 4 and 3, she continued to carry on a business, so any expenditure or loss incurred during this time will be deductible. Angela's intention was always to make a profit, and her decision to diversify her business and shift to an online store to generate income supports this intention. Looking at the nature of the business's activities during Alert Levels 4 and 3, there was a temporary reduction in the volume of transactions and financial results, but these rebounded quickly as the business diversified. Angela continued to commit time, money and effort to the business.

#### *GST*

For GST purposes, Angela continues to be GST-registered. She is still carrying on a taxable activity, her turnover exceeded \$60,000 in the last 12 months, and she expects turnover will exceed \$60,000 in the next 12 months. Even if her turnover is less than \$60,000 in the next 12 months, Angela can choose to remain registered.

### **Example 4 – Boat cruise operator**

#### *Facts*

Wiremu operates a harbour boat cruise business through his company. His customers are almost 100% international tourists. When New Zealand moved to Alert Level 4, Wiremu had no option but to close.

Wiremu plans to reopen during the school holidays and then, hopefully, to reopen fully in 18 months when the borders re-open.

Wiremu gets other flexible employment Monday–Friday to pay the bills. During weekends, he spends a few hours maintaining and running the boat and cleaning and repairing his premises. He occasionally orders fuel and parts from suppliers. He has

also renewed his skipper license. After work, he regularly spends time updating his website and Facebook page, answering booking queries and dealing with refund requests. He researches market conditions and continues to advertise the business. He gets good bookings for the school holidays, so takes a break from his job and has a couple of successful weeks in September and October taking harbour cruises. Wiremu also operates for several days over the Christmas break, despite not being as busy as he used to be with international tourists.

From time to time, Wiremu speaks with the company he leases the boat from and the bank about his loans. The business still owns a ute that he makes payments on.

#### *Income Tax*

The Commissioner considers that the business continues to operate, just on a much-reduced scale. Expenditure incurred during this period is deductible.

Wiremu still clearly has an intention to make a profit. He continues to keep the business assets clean and in working order and has reopened for periods, including the school holidays. He has renewed his skipper's licence and is taking bookings. Looking at the nature of the activities carried on, time, money and effort continue to be committed to the business. The underlying business structure and assets are still available for use, and the business continued to earn income at times throughout the year.

While the volume of transactions and pattern of activity have diminished considerably, this is consistent with the nature of the business as it has adapted to the new conditions New Zealand must operate under.

#### *GST*

For GST purposes, Wiremu's business continues to be GST-registered. He is still carrying on a taxable activity, his turnover exceeded \$60,000 in the last 12 months and he expects it will exceed \$60,000 in the next 12 months. Even if his turnover is less than \$60,000 in the next 12 months, Wiremu can choose to remain registered.

### **Example 5 – Commercial property**

#### *Facts*

Debbie owns a commercial property on the outskirts of a large city, carrying on the business of commercial leasing. Her tenant moved out shortly before New Zealand

entered Alert Level 4. Since then, the property has remained vacant, despite this being an area with a shortage of commercial property spaces. Debbie continues to incur expenditure relating to the property such as council rates, water, power and insurance. She has made no efforts to advertise the property for lease and has engaged a valuer to value the property with a view to selling it.

#### *Income Tax*

The Commissioner considers that the business has ceased. Debbie no longer has an intention to make a profit. This is demonstrated by the fact she has not advertised the property for lease and obtained a valuation for the purposes of selling the property. In terms of the nature of the activity, no real operational activity (leasing or attempts at leasing) is taking place.

#### *GST*

Debbie may still claim back the GST on the valuation and will have to account for GST on the sale of the property because anything done in connection with the beginning or ending of a taxable activity is treated as being carried out in the course or furtherance of the taxable activity (s 6(2) of the GST Act). When her taxable activity has finally ceased, Debbie will need to notify the Commissioner under s 52(3). She will also need to make a GST deregistration adjustment under s 5(3).

### **Example 6 – Backpacker hostel**

#### *Facts*

Malu owns and operates a backpacker hostel. His customers are mainly overseas students and travellers. The business had been struggling for a while with low occupancy rates. On 25 March 2020, things got considerably worse for Malu when New Zealand entered Alert Level 4. Customers stop arriving in New Zealand, and the hostel remains empty. This is the final straw for Malu and on 1 April 2020 he decides to close the doors on the hostel for good. He keeps busy teaching yoga and helping in a local cafe.

In December 2020, Malu is approached by a local orchard owner. The orchard owner would like to use Malu's hostel to house seasonal workers on favourable terms. Malu agrees and re-opens the hostel.

### *Income tax*

The Commissioner considers that from 1 April 2020, there has been a permanent cessation of business, so expenditure incurred after this date is not deductible. Malu does not have an intention to make a profit, and there is insufficient operational activity to satisfy the business test.

However, the costs Malu incurs in operating the hostel from December 2020 for the seasonal workers will be deductible against that income.

### *GST*

For GST purposes, Malu remains GST-registered for a few months to ensure that input tax can be claimed on any costs incurred in winding-up the business (including as part of the taxable activity (s 6(2)). By the end of July, all activities relating to the wind-up have ceased and Malu notifies the Commissioner under s 52(3) that from 31 July he has ceased to carry on a taxable activity. The Commissioner then cancels the GST registration from 31 July (s 52(5A)(a)). Malu makes a deregistration adjustment under s 5(3).

In December 2020, Malu restarts his activity. While he is arguably carrying on a taxable activity again, he does not believe that housing seasonal workers will generate taxable supplies over \$60,000 in the next 12 months. He therefore decides not to register for GST.

## **Example 7 – Café**

### *Facts*

Ari operates a busy café in the Auckland CBD through his company Café Ltd. His customers mainly come from the surrounding businesses. When Ari set up the cafe, he purchased a new cooker and display cabinet. These acquisitions were funded by a bank loan. He has also outfitted a private function room at the back of the café with new tables and chairs. He intended to use this room for hosting catered functions.

On 21 March 2020, New Zealand entered Alert Level 2. Ari purchased hand sanitiser and masks for his staff and pens and clipboards for recording customer contact details. During this time, the number of customers dropped significantly. Many CBD workers chose to work from home. Those that came into the café were understandably concerned about the spread of COVID-19 and ordered their food to take away.

On 23 March 2020, New Zealand entered Alert Level 3. Given the restrictions placed on cafes and the fact that many of his customers were now working from home, Ari temporarily closed the café. Assisted by the wage subsidy, Ari was able to continue to employ his head chef Nina and three other staff members throughout Alert Levels 3 and 4.

On 13 May 2020, New Zealand was back at Alert Level 2 and Ari opened the café again. Customer numbers were down and very few customers were dining-in. By 8 June 2020, New Zealand was at Alert Level 1 and many workers were back in the CBD. Business picked up again.

On 12 August 2020, Auckland was put into Alert Level 3. Ari tried to trade from a table at the front of the store. Again, with most of the CBD workers at home, he struggled to make any money. This pattern was repeated in the February 2021 lockdowns. Towards the end of February 2021, Ari made two staff redundant. He also sold the function room table and chairs, at a loss, as there had been no interest in using the dining room for private catered functions.

#### *Income Tax*

Throughout this period, Ari continues to carry on a business. The business had to temporarily stop trading during Alert Level 4 (and the first Alert Level 3), but there was still an intention to make a profit.

While the business has downscaled, all expenditure or losses incurred will still be deductible. This includes expenditure on hand sanitiser, masks and clipboards. It also includes rent, power, water, insurance, salary payments and KiwiSaver contributions. Redundancy payments are deductible under s DC 1 and the interest on the bank loan (used to acquire the cooker and display cabinet) is deductible under s DB 7.

Ari can also continue to claim depreciation deductions for his fixed assets – such as the cooker and display cabinet under s EE 6. It is not relevant that the cooker and display cabinet were not used during Alert Levels 3 and 4. They were available for use, which is sufficient for the purposes of s EE 1(2)(c).

Ari can also claim a deduction for the loss made on the sale of the private function room table and chairs.

#### *GST*

Ari continues to carry on a taxable activity. While his turnover has now slipped below \$60,000, he expects to have a turnover in excess of \$60,000 in the next 12 months so must stay GST-registered.



Ari must charge output tax on the sale of the function room table and chairs.

### **Example 8 – Guiding business to seed business**

#### *Facts*

Martha ran a guiding business called “Lost in Nature” in one of New Zealand’s national parks. Her customers were mainly foreign tourists. The business operated from a small office near the entrance to the national park and it employed Martha and three guides. It owned two large 4-wheel drive vehicles for transporting customers and some specialist camping equipment.

From 19 March 2020, (when New Zealand closed its borders to international tourists), Martha suddenly had no customers. She struggled to attract New Zealand-based customers, despite a concerted marketing push. The business limped on through 2020 running weekly guided tours. However, the tours were often half-empty, and it was clear this would not be sustainable, especially when the wage subsidy ended.

Martha spent her spare time investigating the possibility of using some land she owned to plant native seedlings for sale. She has a background in horticulture and used her industry contacts to commission a short report. Based on this research, she was confident the business would be profitable. To get things started, Martha had her three employee-guides help her put up some fencing on the land and prepare the soil for planting.

In September 2020, with no likelihood of the border re-opening, Martha stopped advertising “Lost in Nature” and switched to growing and selling native seedlings. Her three employee-guides were employed in the new venture and the 4-wheel drive vehicles were adapted for carrying seedlings and supplies. Martha sold the specialist camping equipment at a loss.

#### *Income Tax*

During this time, “Lost in Nature” downscaled but continued to operate as a business until September 2020. All expenditure or losses incurred up to that point are deductible. There was an intention to make a profit and enough operational activity to satisfy the Commissioner that a business was being carried on.

The loss on the sale of specialist camping equipment is deductible as the sale occurred before the guiding business ceased operating. The sale did not give rise to depreciation recovery income.

Costs incurred in researching the feasibility of undertaking the plant business (including the report) are not deductible as they are feasibility expenditure incurred preliminary to or preparatory to the start of a business. Similarly, costs incurred in fencing and preparing the land for planting are capital costs. Fencing costs may be depreciable as land improvements under sch 13 of the Act.

### GST

Initial orders in the seedling business suggest that Martha is likely to have a turnover exceeding \$60,000 in the next 12 months. Therefore, she must keep her GST registration and cannot deregister. Because the vehicles and building will be used in the new taxable activity, she does not need to make a deregistration adjustment under s 5(3). The sale of the specialist camping equipment must be charged with GST output tax.

## References

### Legislative references

Income Tax Act 2007 – ss DA 1, DA 2, DC 1, DC 2, DC 10, YA 1 (“business”)

Goods and Services Tax Act 1985 – ss 5, 6, 52

Tax Administration Act 1994 – s 6I

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"IS 14/04: Income tax – deductibility of company administration costs", *Tax Information Bulletin* Vol 26, No 7 (August 2014): 5. <https://www.taxtechnical.ird.govt.nz/tib/volume-26---2014/tib-vol26-no7>

## About this document

Interpretation Statements are issued by the Tax Counsel Office. They set out the Commissioner's views and guidance on how New Zealand's tax laws apply. They may address specific situations we have been asked to provide guidance on, or they may be about how legislative provisions apply more generally. While they set out the Commissioner's considered views, Interpretation Statements 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](#) (December 2012). It is important to note that a general similarity between a taxpayer's circumstances and an example in an Interpretation Statement will not necessarily lead to the same tax result. Each case must be considered on its own facts.