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, other than 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 occurs where there is 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:
    - o the last day of the income year in which the tax loss component in question is used; and
    - o 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).
- Where a major change (other than a permitted major change) or a cessation occurs part-way through an income year, the tax loss component in question may be carried forward and set off against income arising up to the time of the major change or cessation respectively if the company provides the Commissioner with adequate financial statements under s IP 6 calculating the company's income for that part of the income year (s IP 3B).
- The main rule in s IB 3(2)(c) is concerned with the nature of the company's business activities. The Commissioner considers "business activities" means "actions taken in pursuit of one or more businesses that may be carried on by the company for income tax purposes" and that "nature" means "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 reference to:
  - its core business processes (eg, farming, manufacturing, development, construction, distribution, retailing, services);
  - the type (ie, category) of products or services produced or provided;
  - significant assets utilised (eg, premises, plant and machinery, livestock, intellectual property, goodwill);
  - where relevant, significant suppliers or other inputs (eg, key staff);
  - scale (eg, approximate turnover or size); and
  - the main markets supplied to (eg, retail/wholesale, local/national/specific territories).
- Determining whether there has been a major change in the nature of a company's business activities requires consideration of whether there has been a change, and, if so, whether the change is major. 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. Any assets the company owns but does not use in deriving its assessable income over the business continuity period must be excluded from relevant assets.
- Certain assets will 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. It is considered that replacement assets that are significantly smaller or larger in size would not be "similar" in character to existing assets for the purposes of s IB 3(4) unless the overall capacity of the assets (in terms of functionality) was the same or similar. Similarly, significantly fewer or more assets of the same type as existing assets would not be "similar" in character to existing assets unless the overall capacity of the assets (in terms of functionality) was the same or similar.

- 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.
- New Zealand 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).
- Depending on the circumstances, where a company (including a deemed single company under s IB 5) produces or provides more than one type of product or service, a significant change in the relativities of those products or services could give rise to a major change in the nature of the company's business activities.
- 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 (s IB 3(5)(a));
  - made to keep up to date with advances in technology relating to a business activity (s IB 3(5)(b));
  - caused by an increase in the scale of a business activity (s IB 3(5)(c)); and
  - caused by a change in the type of products or services produced or provided (s IB 3(5)(d)).
- 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 under s IB 3(5)(d) in two cases:
  - if the change involves starting to produce or provide a product or service using the same, or mainly the same, assets as a product or service that the company produced or provided immediately before the start of the continuity period; or
  - if the change involves starting to produce or provide a product or service that is otherwise closely connected with a product or service that the company produced or provided immediately before the start of the continuity period.

  For the purposes of this permitted major change, assets used to produce or provide a product or service do not include land other than buildings and fixtures (s IB 3(7)).
- 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. In some instances it may be helpful to measure assets for this purpose. To assist with this enquiry, the Commissioner will accept that the "mainly the same" asset requirement is satisfied where at least 75% of existing key assets are used to produce or provide the new type of product or service. This is a 'safe harbour' figure. It does not mean that in certain contexts percentages lower than this will necessarily fail the requirement.
- 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;
  - that significantly enhance the utility or enjoyment of existing products or services; or
  - that are commonly sold together with existing products or services in order to enhance the sales of those 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 (other than a permitted major change) 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, other than a permitted major change.

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

- the meaning of "ownership continuity breach" (from [15]);
- the meaning of "business continuity period" (from [17]);
- 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 [35]);
- how the rule applies to groups of companies (from [69]); and
- permitted major changes (from [75]).

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) and s 99(2) of the Taxation (Annual Rates for 2020–21, Feasibility Expenditure, and Remedial Matters) Act 2021) (see Example 1);

  Example 1 – Early balance date

  Hives Honey Ltd carries on a beekeeping business and has a 31 December balance date. The company incurs losses in its 2019/20 income year. On 1 February 2020, the company has an ownership continuity breach, but does not change the nature of its business activities. The company can rely on the business continuity test to carry forward its losses as the ownership continuity breach occurred in its 2020/21 income year. This is despite the breach occurring prior to the commencement date of the provision enacting subpart IB on 1 April 2020.

- 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));
- the company has not had another ownership continuity breach from (and including) the later of the income year in which the tax loss arose and the 2020/21 income year 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)) (see Example 2);

  Example 2 – Intervening ownership continuity breach

  Flip Flop Ltd incurs $3.5m of losses in the 2020/21 income year from its sandal manufacturing business. The following income year (2021/22), the company has an ownership continuity breach and changes the nature of its business activities to IT consultancy services. The change is

> a major change that is not a permitted major change. Later that year, the company has a further ownership continuity breach and returns to its roots manufacturing sandals. The new owners cannot rely on the business continuity test to carry forward the tax losses from the 2020/21 income year past the second ownership continuity breach because there was an intervening ownership continuity breach in relation to which the major change rule in s IB 3(2)(c) was not satisfied.

- for tax losses arising before the 2020/21 income year, those losses could be carried forward to the 2020/21 tax year without needing to rely on subpart IB (s IB 3(3)(c)) (see Example 3); and

  Example 3 – Pre-2020/21 ownership continuity breach

  > Change Services Ltd, a firm of change consultants, incurred $400,000 of tax losses in the 2017/18 income year, and had an ownership continuity breach in the 2019/20 income year. In the 2021/22 income year there is a further ownership continuity breach. The nature of the company's business activities have remained the same throughout. The new owners cannot rely on the business continuity test to carry forward the tax losses arising prior to the ownership continuity breach in the 2019/20 income year because those losses could not be carried forward to the 2020/21 tax year without relying on subpart IB.

- 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 certain tax losses of companies that are mineral miners (see s IB 3(5B)).

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. The targeted anti-avoidance rules can potentially apply where there is an arrangement under which:

    - a company pre-emptively changes the nature of its business activities in the 2 years prior to an ownership continuity breach in order to enable the business continuity test to be satisfied after the breach (s GB 3BA);
    - a company that carries forward losses under the business continuity test derives income that would otherwise have been derived by an associated person (such as another group company) (s GB 3BAB); or

- an associated person of the company that carries forward losses under the business continuity test (such as another group company) incurs expenditure or loss that would otherwise have been incurred by the loss company (s GB 3BAC).

13. Except for the cessation rules in s IB 3(2)(b) and 3(3)(a) (which are discussed from [99]), these other requirements and targeted anti-avoidance rules are not discussed in this interpretation statement.

14. Appendix One contains a flow chart that can help to 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?

15. 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

16. For the purposes of the business continuity test, an ownership continuity breach for a company will occur if there has been 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?

17. 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).

18. 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.

19. 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.

20. For a tax loss component to be carried forward, no major change in the nature of the business activities carried on by the company (other than a permitted major change) 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 carries 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). Further, the company must not cease to carry on business activities during the business continuity period (s IB 3(2)(b)).

21. Where a major change (other than a permitted major change) or a cessation occurs part-way through an income year, the tax loss component in question may be carried forward and set off against income arising up to the time of the major change or cessation respectively if the company provides the Commissioner with adequate financial statements under s IP 6 calculating the company's income for that part of the income year (s IP 3B).

22. Finally, 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. This will be the case even if the tax return for the earlier income year has not been filed by the date of the major change (see Example 4).

Example 4 – Earlier used losses and part year losses

Photo Developments Ltd has a standard balance date (31 March) and has an ownership continuity breach in the 2020/21 income year. The company relies on the business continuity test to carry forward $1m of tax losses from prior to the breach and subtracts $800,000 of those losses from income arising in the 2021/22 income year.

On 1 July 2022, the company makes a major change in the nature of its business activities that is not a permitted major change, and accordingly fails the business continuity test. The $800,000 of losses carried forward under the test and used in the 2021/22 income year are not affected by the subsequent major change.

The company prepares financial statements calculating its income for the part of the 2022/23 income year prior to the major change, which enables it to offset a further

$50,000 of the losses. The major change prevents the remaining $150,000 of losses from being carried forward beyond 1 July 2022.

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 inquiry 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.

27. The Commentary explains that the term "business activities" was used to ensure that the business continuity test is not applied granularly on a business-by-business basis. In the Commissioner's view, this means that where a company carries on more than one business the intention is that the continuity of each business does not have to be considered separately; rather, it is the continuity of the combined business activities that is relevant.

28. The main 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.

29. An important issue is determining the relevant features, qualities or character of a company's business activities for this purpose. In interpreting any provision, regard must be had to the text of the provision in the light of its purpose and its context: s 10 of the Legislation Act 2019.

30. By way of context, s IB 3 indicates that particular features of a company's business activities are relevant to determining whether or not the company has had a major change in the nature of its activities:

- Section IB 3(4) requires the extent to which the assets used in deriving a company's assessable income have remained the same or similar to be taken into account (see further from [46]).
- Section IB 3(5) indicates various other factors that may also be relevant, including business processes, suppliers, other inputs, scale, the markets supplied to and the type of product or service produced or provided (see further from [66]).

It follows that these features will inform the nature of a company's business activities.

31. Differing levels of granularity can be used to describe the above features, and, therefore, the nature of a company's business activities. The specified purposes of the business continuity test, including promoting innovation, economic growth and resilience, suggest a less granular approach. However, another purpose is not to encourage tax avoidance arrangements involving share acquisitions (that is, loss trading), so the descriptions should not be so broad as to permit such arrangements.

32. Consistent with this, it is considered that the nature of a company's business activities should be described by reference to:

    - its core business processes (eg, farming, manufacturing, development, construction, distribution, retailing, services);
    - the type (ie, category) of products or services produced or provided;
    - significant assets utilised (eg, premises, plant and machinery, livestock, intellectual property, goodwill);
    - where relevant, significant suppliers or other inputs (eg, key staff);
    - scale (eg, approximate turnover or size); and
    - the main markets supplied to (eg, retail/wholesale, local/national/specific territories).

33. Where a company undertakes more than one core business process, each process should be referred to (for example, manufacturing and distribution), rather than adopting a global descriptor.

34. Similarly, where a company produces or provides more than one type of product or service, each type of product or service and their approximate relativities should generally be referred to. This will be particularly relevant to groups of companies that are treated as a single company under s IB 5 (see below from [69]). For example, the nature of the business activities of a group of companies that includes car dealerships and garages for servicing cars should refer to both car retailing and automotive servicing and their approximate relativities. Despite this, in some contexts, a broader description of products or services may be appropriate. For example, a large retailer

that sells a wide range of products including homewares, electrical goods, sports equipment, clothing and toys could be more broadly described as a retailer of consumer goods.

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

35. The definition of "change" in the *Concise Oxford English Dictionary* includes "an instance of becoming different". "Major" is defined as "important, serious, or significant. ▪ greater or more important; main".

36. 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 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". The issue was whether the activities of the taxpayer satisfied a definition of that phrase in s 483(3) that included (among other things) a "major change in customers, outlets or markets of the trade".

37. 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]

38. In summary, Gibson LJ approached the "major change" test in two parts: first considering qualitatively whether there had been a change, and then considering as a question of degree whether the change was major, with "major" meaning "of greater … importance". Lowry LCJ, in a separate judgement, 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 in New Zealand, it is likely that New Zealand courts would adopt a similar approach given the common subject-matter. However, one distinction is that the nature of a company's business activities for the purposes of the business continuity test (see above from [23]) includes features that can be measured quantitatively (such as scale and assets), so the first step of the major change test could have both qualitative and quantitative elements.

40. This approach to the "major change" test is also consistent with the Commentary, which states that not every change will be a major change, and that whether a change is a major change will generally be a question of 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 [46]). But the legislation does not otherwise limit or specify the factors that may be taken into account. The Commentary states that the test is not intended to give special weight to any particular factor. Other potentially relevant factors are discussed from [66].

42. In practice, the nature of a company's business activities immediately prior to the ownership continuity breach should first be compared to the nature of its activities at all relevant times following the breach to determine whether there has been a change. This exercise should take into account continuity of assets and any other relevant factors, assessing changes at the appropriate level of granularity (as discussed from [31]).

43. If there has been a change, it is then necessary to determine whether that change is a major change. A 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. This will be a question of fact and degree.

44. Where a company produces or provides more than one type of product or service, a significant change in the relativities of those products or services could give rise to a major change in the nature of the company's business activities, depending on the relevant factors.

45. Overall, the relevant factors to be taken into account and their weight will depend on the particular circumstances.

Assets factor

46. 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
>
> …

47. 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.

48. "Assets" are not defined in the Act for the purposes of s IB 3(4). "Asset" is defined in the *Concise Oxford English 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".

49. 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;
    - 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]

50. In interpreting the meaning of "assets" in s IB 3(5), regard must be had to the text of the provision in the light of its purpose and its context: s 10 of the Legislation 2019. As discussed earlier, the purposes of subpart IB include promoting innovation, growth, and resilience, but not encouraging tax avoidance arrangements (that is, loss trading).

[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].

[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].

51. 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 in 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.

52. Practically, the Commissioner considers that the 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. Depending on the context, changes in the people involved in a business may be relevant under other factors (see at [67]).

53. 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.

54. Certain assets will be more relevant to the question of whether there has been a major change than other assets. For example, key business assets such as manufacturing plant, specialised equipment, or intellectual property will be important, whereas generic office premises, generic office equipment, and working capital will typically be of little relevance.

55. Changes in key 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:

- numbers of different types of assets;
- value of different types of assets; or
- area or floorspace occupied by different types of assets.

56. The most appropriate way of assessing changes in assets will depend on the context. Similarly, the most appropriate way of valuing assets for this purpose will depend on

the context. For example, assessing changes by reference to the book value of assets may not be determinative where assets have been significantly depreciated in a company's accounts. In such cases, historic cost, replacement value or market value may be more appropriate depending on the context.

57. In some instances it may be helpful (or necessary) to value an asset for the purposes of applying the test. For example, a key asset may not be recognised in a company's financial statements (see at [52]), or it may otherwise be appropriate to use the market value of a key asset in a particular context. In such cases, a commercially orthodox valuation methodology should be used.

Same or similar assets

58. 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.

59. 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.

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

61. The Commentary states that some categories of asset require replacement and that the reference to same or similar assets is to clarify that the "normal replacement of specific assets" should not be part of the assessment of whether a major change has occurred.

62. The references to "replacement" in the Commentary suggest that "similar" in this context requires assets of the same kind in character (ie, function). 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 character (ie, they perform the same function) as the assets they are replacing without being identical, this aspect of the definition will be satisfied.

63. The reference to "normal replacement of specific assets" in the Commentary also suggests that similarity in size and number is relevant. The assets of a company may need to be replaced, reduced or supplemented when its business activities are changing in scale. For example, existing assets may need to be replaced with smaller or larger assets, or reduced or increased in number. It is considered that replacement assets that are significantly smaller or larger in size would not be "similar" in character to existing assets for the purposes of s IB 3(4) unless the overall capacity of the assets (in terms of functionality) was the same or similar. Similarly, significantly fewer or more assets of the same type as existing assets would not be "similar" in character to existing

assets unless the overall capacity of the assets (in terms of functionality) was the same or similar.

64. This interpretation is supported by the permitted major change for increases in scale (see from [86]), which implies that a significant change in the size or number of existing assets is a factor that could give rise to a major change. Further, allowing significant decreases in scale under the "same or similar" rule in s IB 3(4) would be inconsistent with the fact that only increases in scale are permitted major changes.

65. If a company acquires significantly larger assets or significantly more assets of the same type as existing assets, the permitted major change relating to increases in scale may be relevant (see Example 5).

Example 5 – 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 seizes 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 under s IB 3(2)(c). Even if it did, the permitted major change for increases in scale in s IB 3(5)(c) would apply.

Other factors that may be taken into account

66. 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 [80] and from [84], respectively) suggest that changes in business processes and suppliers or other inputs may be relevant;
- the scale permitted major change (discussed from [86]) suggests that changes in scale and the markets supplied to may be relevant;
- the type of product or service permitted major change (discussed from [88]) 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.

67. 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.

68. 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 (see Example 6).

Example 6 – 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. The company has a turnover of approximately $700,000 annually. 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 using the key assets of its bakery premises, automated bread production line and delivery vehicles, and a key supplier of flour. The company supplies local supermarkets, bakes 2,000 loaves a day and has a turnover of approximately $700,000.

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 bakery premises, 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, functionally the same 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 key 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.

Other key inputs have changed though, with the hiring of a specialist artisanal baker and an increase in staff numbers because of the more labour-intensive production process.

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.

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.

The changes in staff and scale of production suggest that there has been some change in the nature of the company's business activities. Accordingly, it is necessary to consider whether that change is a major change.

The introduction of a key artisanal baker into the business and the increase in staffing levels are not indicative of a major change. These changes merely enable the company to carry out the same business process in a different way.

Further, the reduction in the scale of output is not indicative of a major change in this context. The reduction in the scale of output is a result of an improvement in the quality of the bread being baked, which is reflected in higher margins.

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.

How does the rule apply to groups of companies?

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

> **IB 5 When group companies treated as single company**
>
> New Zealand resident 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).

70. New Zealand resident 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).

71. When determining the nature of the business activities carried on by a deemed single company, the focus of the description should be on the products or services that are sold or provided to customers outside of the group. For example, administrative services provided by a holding company solely to other companies that are part of the same single company under s IB 5 would not be a type of service provided by the single company for the purposes of applying the business continuity test.

72. Similarly, when assessing the continuity of assets of the deemed single company, wholly intra-group assets should be ignored, such as a holding company's shares in its subsidiaries (see Example 7).

73. In addition:

    - where the deemed single company undertakes more than one core business process each core business process should be referred to (see above at [33]); and
    - where the deemed single company produces or provides more than one type of product or service each type of product or service produced or provided (and their approximate relativities) should generally be referred to (see above at [34]).

74. Depending on the relevant factors, where a deemed single company produces or provides more than one type of product or service, a significant change in the relativities of those products or services could give rise to a major change in the nature of the company's business activities (see also at [44]).

Example 7 – Nature of the business activities of a deemed single company

The Central Storage group owns and operates a storage unit business. The group consists of a holding company, which owns 100% of the shares in a property-owning company and 100% of the shares in an operating company. All of the companies are resident in New Zealand for tax purposes.

The operating company typically has a turnover of around $1m per annum. However, restrictions on international travel have a negative impact on demand for storage, and the operating company incurs losses in the 2021/22 income year.

The property-owing company charges the operating company a market rent for the lease of the storage facility and generates a small taxable margin after deductible expenses each year.

The holding company operates on a break-even basis by annually charging its subsidiaries management fees equal in aggregate to its deductible costs.

The shareholders of the group decide to exit the business and sell 100% of the shares in the holding company to an unrelated purchaser, giving rise to an ownership continuity breach for each of the group companies. The purchaser continues to operate the Central Storage business in the same manner following its acquisition.

Because the companies forming the Central Storage group are part of the same group of companies immediately before and immediately after the ownership continuity breach, the companies are treated as a single company for the purposes of subpart IB and its associated avoidance provisions (s IB 5).

When determining the nature of the business activities of the deemed single company, the intra-group property leasing and management services should be ignored, and the holding company's investment in its subsidiaries should not be taken into account as a relevant asset.

It follows that the nature of the deemed single company's business activities will be the provision of storage services to the local market using the key asset of the storage facility, and with a turnover of around $1m. There are no notable suppliers or other inputs.

Following the ownership continuity breach there is no change to the nature of the business activities of the deemed single company. Accordingly, the losses arising in the operating company prior to the ownership continuity breach can be carried forward past the breach under s IB 3.

Under the existing loss grouping rules in subpart IC, the losses arising in the operating company prior to the ownership continuity breach will be available to offset against income arising in the property-owning company both before and after the breach.

The purchaser of the group must assess the impact of any future changes to the nature of the business activities of the deemed single company against the nature of the business activities of the deemed single company carried on immediately prior to the ownership continuity breach.

What are the permitted major changes?

75. 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 that the company carried on immediately before the beginning of the business continuity period:
>
> (b) made to keep up to date with advances in technology relating to a business activity that the company carried on immediately before the beginning of the business continuity period:
>
> (c) caused by an increase in the scale of a business activity that the company carried on immediately before the beginning of the business continuity period, including as a result of the company entering a new market for a product or service that it produced or provided at that time:
>
> (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.

76. 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 relating to a business activity;
- 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.

77. 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.

78. 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.

79. A company can have multiple major changes in the nature of its business activities, provided each major change is a permitted major change (s IB 3(2)(c)). Following a permitted major change, the nature of the business activities of the company still need to be assessed against the business activities carried on immediately prior to the ownership continuity breach.

Changes to increase efficiency

80. Major changes that are made to increase the efficiency of a business activity that the company carried on immediately before the beginning of the business continuity period are permitted under s IB 3(5)(a). "Efficiency" is defined in the *Concise Oxford 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.

81. 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 (see Example 8).

82. 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.

83. As discussed at [32], for the purposes of s IB 3(2)(c), business activities should be described by reference to a number of features including the type of product or service produced or provided. A change to a different type of product or service that is either

cheaper to produce or provide, or more profitable, is not increasing the efficiency of an existing business activity. Such a change (if it contributes to a major change) should be considered under the permitted major change relating to products and services (see from [88]).

Example 8 – Outsourcing a manufacturing operation

Expeditions Unlimited Ltd designs and manufactures high-quality outdoor equipment in its 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 using the key assets of a factory, intellectual property in its designs and branding, and goodwill, and the key input of its design team. The company supplies domestic and international wholesalers, and its turnover is approximately $40m annually.

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

84. Major changes that are made to keep up to date with advances in technology relating to a business activity that the company carried on immediately before the beginning of the business continuity period are permitted under s IB 3(5)(b). This could be satisfied, for example, where a new technology enables greater output of an existing product or service (see Example 9).

85. In contrast, changes to producing or providing a type of product or service based on an emerging technology that is unrelated to a business activity that the company carried on immediately before the beginning of the business continuity period will not fall within this permitted major change (see Example 10).

Example 9 – 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 SDL's assets is made to keep up with driverless vehicle technology which is relevant to its courier business, 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).

Example 10 – Unrelated technology advances

Ariana is a keen brewer of craft beer. She decides to go into business brewing beer from her garage and incorporates a company to carry on the business. The first year proves more difficult than Ariana anticipated and the company suffers losses.

The following year, Ariana becomes interested in aerial photography. Recent advances in technology mean that high-quality drones are now more affordable. Ariana decides that the company should sell off its brewing equipment and acquire a high-end drone. Her friend, Patricia, who has access to the necessary capital, joins the company as a majority shareholder breaching ownership continuity. The company uses the newly acquired drone to establish a thriving aerial photography business.

The company has had a major change in the nature of its business activities. The change will not be a permitted major change under s IB 3(5)(b), as although the new drone reflects an advance in technology, the technology is unrelated to the brewing business activity.

Increases in scale

86. Major changes caused by an increase in the scale of a business activity that the company carried on immediately before the beginning of the business continuity period are permitted under s IB 3(5)(c). Companies may grow organically or by way of acquisition (or a combination of these two things). Provided the increase in scale relates to a business activity that the company carried on immediately before the beginning of the business continuity period, this permitted major change will be satisfied.

87. Increases in scale include increases because the company is entering a new market for a product or service that it produces or provides. 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

88. 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)).

89. 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.

90. 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.

91. A "type" of product or service is a category of things having common characteristics.

92. 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.

93. Case law indicates that when the term "mainly" is used in conjunction with the "same" (or its synonyms) it is capable of a range of meanings from "more than half" to "substantially all", depending on context and the purpose of the relevant provision (see for example *CIR v Mitchell* (1986) 8 NZTC 5,181 (HC) at 5,183 and *British Association of Leisure Parks, Piers & Attractions Ltd v Revenue and Customs Commissioners* [2011] TC 01504 (UKFTT) at [39]).

94. The purposes of promoting growth, innovation, and resilience support a broader interpretation of mainly, 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 [97]), which implies a more restricted interpretation of mainly. On balance, it is considered that a more restricted interpretation of mainly is appropriate in this context.

95. The focus of the enquiry should be on the key assets used in the business activity. Again, particular assets will be more relevant than others, depending on the context (as discussed at [54]).

96. In some instances it may be helpful to measure assets for this purpose. There are a number of ways that assets can be measured (see the discussion at [55] and [56]). The most appropriate way will depend on the context. To assist with this enquiry, the Commissioner will accept that the "mainly the same" asset requirement is satisfied where at least 75% of existing key assets are used to produce or provide the new type of product or service. This does not mean that in certain contexts percentages lower than this will necessarily fail the requirement.

97. 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.

98. 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;
- that significantly enhance the utility or enjoyment of existing products or services; or
- that are commonly sold together with existing products or services in order to enhance the sales of those products or services (see Examples 11 to 15).

Example 11 – 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 has an annual turnover of approximately $200,000, and employs two part-time staff members in addition to Derek. 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 generic 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 monthly turnover. 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 nature of Book Worm Ltd's business activities was book retailing to the local market. The key assets of the business were its trading stock of books, retail fit-out and some level of goodwill (not reflected in its accounts); the remaining assets are generic business assets. A key input is the company's relationships with various book suppliers and publishers.

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.

The trading stock of books, retail fit-out and goodwill continue to be used in the new business. However, new key 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).

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. The premises 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.

It follows from the above analysis that there has been a change in the nature of the company's business activities. Accordingly, it is necessary to determine whether that change is a major change – in other words, whether the change is of greater importance in the context of the operations of the entire company.

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 monthly turnover.

New key assets have also been acquired by the company. The cost of the new assets is roughly equal to the combined value of the existing key assets (measured at book value). However, assessing the level of change by reference to book value is not determinative in this context, because the existing assets have been heavily depreciated in the company's accounts. If the existing key assets were instead valued at replacement value, the ratio of new assets to existing assets would be about one-quarter. Therefore, the continuity of assets does not suggest a major change.

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 provision of coffee uses the key assets of the café counter, work bench, tables and chairs, coffee machine, other appliances, crockery, and glassware. The provision of books uses the key assets of the trading stock of books and the shelving and display stands. While the trading stock of books and shelving and display stands arguably contribute to the backdrop and atmosphere of the café, they are not key assets for the provision of coffee. The goodwill arguably contributes to both business activities. The IT and office equipment are not given any weight in this context as they are generic business assets. It follows that the provision of coffee does not use the same or mainly the same assets as the provision of books.

The remaining issue is whether coffee is otherwise closely connected to books. The inclusion of cafés within bookstores is relatively common practice: the café encourages more customers into the bookstore for longer periods of time, and customers are able to peruse the books while drinking coffee. The inclusion of the café is intended to enhance the sale of books, as well as providing an additional income stream. It follows that the Commissioner will view the connection between the new product (coffee) and the old product (books) as close. The provision of coffee in this context will therefore be closely connected to the provision of books, and therefore the major change will be a permitted major change within s IB 3(2)(c).

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 with the key assets, inputs, markets supplied to and scale as described above. 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 again whether that major change is a permitted major change.

The only common assets are now the office and IT equipment but these are not given any weight in this context as they are generic business assets. Accordingly, the café business does not use mainly the same assets as were previously used for the provision of books.

Despite this, it is considered that coffee is closely connected to books for the reasons discussed above. It follows that the major change will be a permitted major change within s IB 3(2)(c) and therefore the company can carry forward the remaining unused losses that arose prior to the ownership continuity breach.

Example 12 – 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 monthly turnover.

Analysis

Before the ownership continuity breach, the nature of the company's business activities was the provision of real estate agency services to the local market using the key input of Judy and the key asset of her goodwill. The business is a micro-business with one full-time and one part-time employee.

The issue is whether the introduction of the property management activities has given rise to a major change in the nature of those business activities that is not a permitted major change.

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 company's remaining assets largely consist of generic office equipment (that is, laptops, mobile phones and other office equipment) which are not given any weight in this context.

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 and the markets supplied to (that is, commercial property buyers/owners) remain the same.

However, 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. This has also given rise to an increase in scale in the company's business activities.

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 monthly turnover.

It follows that there has been a change in the nature of the company's business activities. Accordingly, it is necessary to determine whether that change is a major change.

The fact Alan's side of the business quickly generates 60% of the company's monthly turnover 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 type of service the company provides has had an approximate 60% change, and personnel and the scale of the business activities have significantly changed to enable this. In contrast, the business processes, suppliers, and markets supplied to have not changed materially.

It is considered that the changes in key assets, type of service provided, personnel and scale 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. Again, generic business assets are not given any 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. Property management services enhance the utility of the real estate agency services, as owners of commercial real estate are likely to also need property management services. In addition, property management services are commonly provided together with real estate agency services and enhance sales opportunities for 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. The Commissioner will therefore regard the connection between the real estate agency services and property management services as close.

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.

Example 13 – Agritech start-up

Facts

Jocelyn, an agricultural scientist, founds a company in the 2020/21 income year to undertake research and development into a hemp-based stock feed that reduces methane emissions from cattle. The company is initially funded by Jocelyn from her own savings and loans from family members. The company employs Jocelyn to work full-time in the business, together with a research assistant and a lab technician.

During the 2021/22 income year the research and development progresses well. An angel investor invests $1.5m for a 40% stake in the company. The investment enables the company to hire an additional scientist and assistant, and to upgrade its lab facilities. At the same time, a further 15% of the company's shares are set aside for an employee share ownership plan. Together, these transactions breach ownership continuity.

By the 2023/24 income year a viable product has been developed, and significant investment is required to build a production facility and establish a supply chain. A venture capital fund takes a 60% stake for $25m for this purpose, again breaching ownership continuity.

In the 2024/25 income year the production facility is fully operational and the company begins deriving revenue from the sale of the stock feed.

The company is loss-making throughout the entire period, and wishes to know whether it can carry forward its losses from prior to both the first and second ownership continuity breaches to the 2024/25 income year.

Analysis

It is assumed that the activities of the company satisfy the requirements of the *Grieve* business test from the outset.

The nature of the company's business activities prior to the first ownership continuity breach consisted of research and development of stock feed using the key input of Jocelyn, and the main assets of intangibles (ie, Jocelyn's know-how) and lab equipment. During this period the company was producing intangibles (ie, know-how/trade secrets), had no turn-over, 3 employees, and supplied no markets.

After the first ownership continuity breach the nature of the company's business activities is essentially unchanged. Although the number of employees has increased, the company is still a micro-business. It follows that the test in s IB 3(2)(c) will be satisfied, and any losses arising prior to the first ownership continuity breach can be carried forward past the first breach under s IB 3.

Further, as the requirements of both IB 3(2)(b) and (c) are satisfied, losses from before the first ownership continuity breach will not be prevented from being carried past a further breach by s IB 3(3)(b).

After the second continuity breach the nature of the company's business activities has changed in many respects from that carried on immediately before both the first and second ownership continuity breaches. The company is now predominantly involved in the manufacturing of animal food using specialist manufacturing equipment and the intangibles created during the research and development phase. Turnover is approximately $2m and the company now employs over 50 staff. The markets supplied are domestic animal food wholesalers and retailers.

As there has been a change in the nature of the company's business activities, it is necessary to determine whether that change is a major change – in other words, whether the change is of greater importance in the context of the operations of the entire company.

It is considered that there has been a major change. The company has moved from the research and development stage to full production, which has involved significant changes in assets and other inputs, business processes, scale, and the markets supplied to.

It is therefore necessary to consider whether the major change is a permitted major change. The most relevant permitted major change in this instance is s IB 3(5)(d) which relates to changes in the type of product or service produced or provided.

It is considered that the requirements of this permitted major change will be satisfied. The major change was caused by the company starting to produce a product – stock feed. The stock feed is closely connected to the intangibles (ie, know-how/trade secrets) that the company produced immediately before each ownership continuity breach, because it is the product of those intangibles.

It follows that losses arising prior to both the first and second ownership continuity breaches can be carried forward to the 2024/25 income year.

Example 14 – Failing the test

Facts

Sunshine Holiday Camp Ltd owns a 2-hectare 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 using the key assets of the land and the various buildings. There are no other notable inputs. The scale of the camping ground is 2 hectares, and the market supplied to is domestic and international holiday-makers.

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 various buildings are no longer used. The value of the land significantly outweighs the value of the other camping ground assets that are disposed of.

Business processes have changed considerably, as has the market 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 that there is a change in the nature of the business activities, and that the change is a major change.

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.

Example 15 – Diversified group example

The Contact Media group owns five local newspapers across New Zealand, each of which is operated through a separate subsidiary. The group has also recently set up a new subsidiary that owns and operates an online classified advertising business. The newspaper businesses account for approximately 80% of the turnover of the group, but due to competition from online news services, have suffered significant losses in recent years. The online classified advertising business makes up the remaining 20% of turnover and is currently breaking even. It is considered that the newspaper businesses and the online classified advertising business are each a distinct business activity for the purposes of the permitted major change tests in s IB 3(5) (which refer to "a business activity" that the company carried on immediately before the beginning of the business continuity period).

A new investor takes a majority stake in the holding company of the Contact Media group giving rise to an ownership continuity breach for all of the companies in the group. At the new investor's instigation, the local newspaper businesses are sold off over the space of a year so that the group can focus on the online classified advertising business, which is considered to have stronger growth potential. The proceeds of sale are used to repay debt owed by the relevant newspaper business subsidiaries.

Because the companies forming the Contact Media group are part of the same group of companies immediately before and immediately after the ownership continuity breach, the companies are treated as a single company for the purposes of subpart IB and its associated avoidance provisions (s IB 5).

Prior to the ownership continuity breach the nature of the business activities of the deemed single company included:

- newspaper publishing:
  - using key assets of printing presses, distribution networks, intellectual property (mastheads, etc), land and buildings;
  - using key suppliers of news content and publishing consumables (eg, newsprint, ink, etc);
  - using key inputs of specialised employees (editors, journalists, printers, etc);
  - supplying newspapers to a number of provinces across New Zealand;
  - with a turnover of approximately $4m;
- online advertising services:
  - using key assets of a technology stack and intangibles;
  - using a key input of software developers;
  - providing advertising services to business and private customers nationwide;
  - with a turnover of approximately $1m.

In terms of relativities, the newspaper publishing business accounts for 80% of the deemed single company's turnover, and the online advertising services business accounts for 20%. It follows that the nature of the business activities of the deemed single company prior to the ownership continuity breach is predominantly newspaper publishing.

After the three most profitable newspaper publishing businesses have been sold off, the combined turnover of the remaining newspaper businesses is approximately $600,000. At this point in time, the remaining newspaper businesses account for 37.5% of the deemed single company's turnover, and the online advertising services business accounts for 62.5%. It follows that the nature of the business activities of the deemed single company is now predominantly online advertising services.

It is considered this will constitute a change in the nature of the business activities carried on by the deemed single company which is a major change. This is because the product, business process, key assets, key suppliers and other key inputs associated with the online advertising have increased significantly in importance relative to the newspaper publishing factors. Further, the overall scale of the business activities have reduced, and the markets supplied to have changed to an extent.

It is therefore necessary to consider whether the major change is a permitted major change.

The major change caused by selling off the newspaper publishing businesses does not increase the efficiency of an existing business activity carried on by the deemed single company. The change does not maintain the same level of newspaper output with reduced costs, nor increase the level of newspaper output without increasing costs. Further, it does not impact on the efficiency of the online advertising business.

The major change caused by winding down the newspaper publishing businesses is not made to keep up to date with changes in technology. Selling off print-based newspaper publishing businesses would not satisfy this requirement unless it was, for example, accompanied by a shift to an online news platform.

The major change is not caused by an increase in the scale of a business activity carried on by the deemed single company. It is caused by decrease in the scale of the newspaper publishing activity.

Finally, the major change is not 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. No new products or services are produced or provided as a result of winding down the newspaper publishing businesses. It is therefore immaterial whether the newspapers and the online classified advertising are "closely connected" products and services.

It follows that the losses arising prior to the ownership continuity breach cannot be carried forward under s IB 3.

What are the cessation rules?

99. A tax loss cannot be carried forward if, before the beginning of the business continuity period, the business activities the 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)).

100. 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?

101. 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)).

102. 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. …

103. A taxpayer will also cease to be in business when there is insufficient activity to constitute a business. 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.

104. *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.

105. 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.

106. 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?

107. 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.

108. The distinction between temporary cessation and cessation with the possibility of recommencement is considered in detail in "IS 21/04 Income tax and GST – deductions for businesses disrupted by the COVID-19 pandemic", *Tax Information Bulletin* Vol 33, No 9 (October 2021): 8.

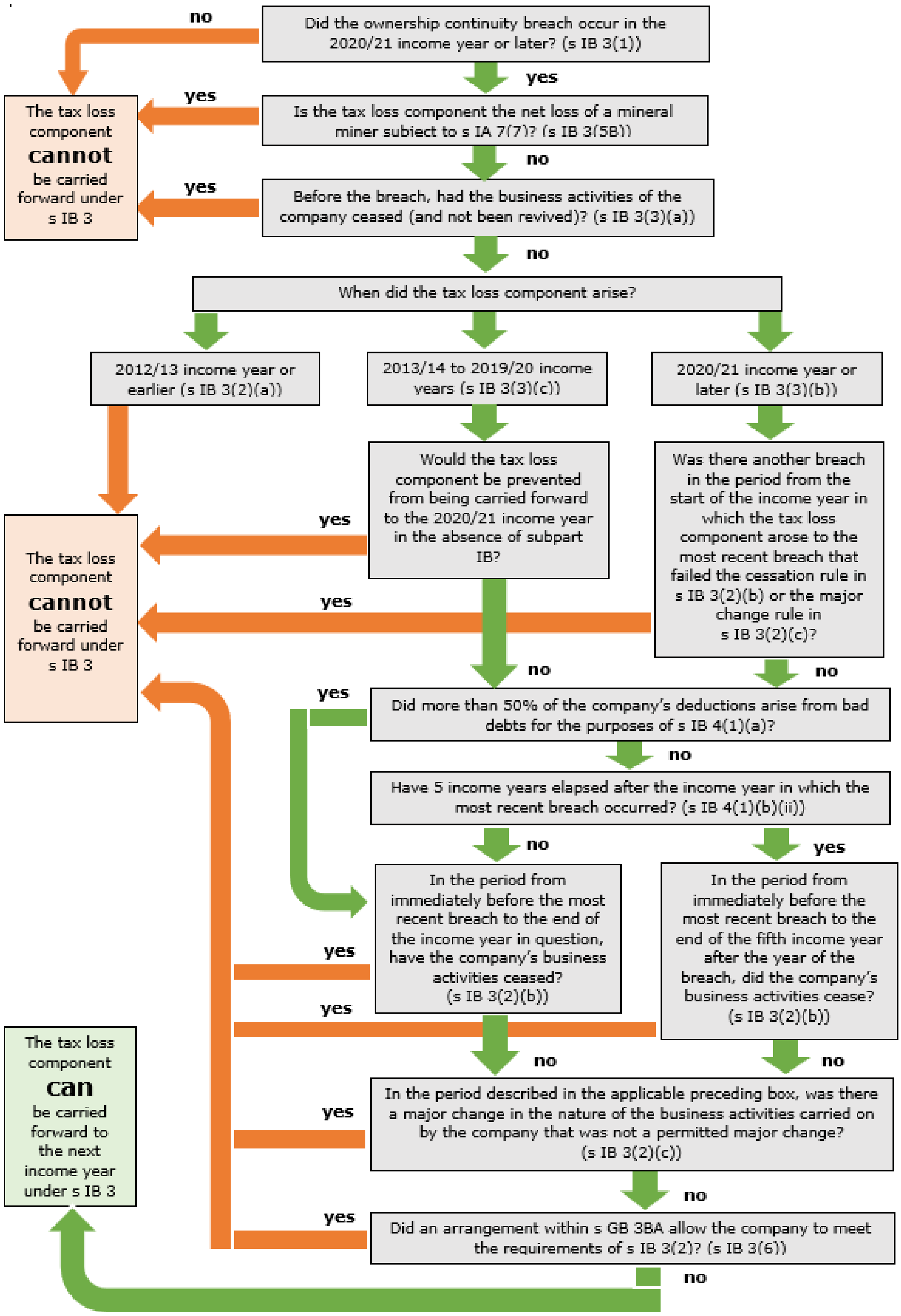
109. For the purposes of s IB 3(3)(a) and IB 3(2)(b), a temporary cessation will **not** constitute a cessation of business activities. In contrast, cessation with the possibility of recommencement will constitute a cessation.

Have the business activities been revived?

110. "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

This flow chart can help to 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

111. 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 company has had another ownership continuity breach—

(i) since the later of the beginning of the earlier income year and the beginning of the 2020–21 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 the tax loss component could not be carried forward to the 2020–21 tax year in the absence of this subpart.

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 that the company carried on immediately before the beginning of the business continuity period:

(b) made to keep up to date with advances in technology relating to a business activity that the company carried on immediately before the beginning of the business continuity period:

(c) caused by an increase in the scale of a business activity that the company carried on immediately before the beginning of the business continuity period, including as a result of the company entering a new market for a product or service that it produced or provided at that time:

(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.

Exclusion: mining net losses

(5B) This section does not apply to an amount referred to in section IA 7(7) (Restrictions relating to ring-fenced tax losses) that is treated by subsection (1B) of that section as if it were a tax loss component.

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

New Zealand resident 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).

IP 3B Business continuity breach: tax loss components of companies carried forward

When this section applies

(1) This section applies for the purposes of section IA 4 (Using loss balances carried forward to tax year) if a tax loss component of a company would have been carried forward under section IB 3 (When tax loss components of companies carried forward despite ownership continuity breach) to a tax year but for a breach or breaches, during the income year that corresponds to the tax year, of either or both of the requirements of section IB 3(2)(b) and (c).

Tax loss components for earlier income years

(2) Despite the breach or breaches, the tax loss component is carried forward to the tax year to the extent to which—

(a) the requirements of section IB 3(2)(b) and (c) would be met if the relevant period described in section IB 4 (Business continuity period) included only part of the income year of the company that corresponds to the tax year; and

(b) the company has net income for part of the corresponding income year; and

(c) the company provides the Commissioner with adequate financial statements under section IP 6 calculating the amount of the company's net income for the relevant part of the corresponding income year.

Limit on tax loss components carried forward

(3) The total tax loss components carried forward under subsection (2) must be no more than the amount calculated under subsection (2)(b) and (c), although the amount may be increased if section IP 5 applies.

References

Case References

AAA Developments (Ormiston) Limited v Commissioner of Inland Revenue (2015) 27 NZTC 22-026 (HC)

British Association of Leisure Parks, Piers & Attractions Ltd v Revenue and Customs Commissioners [2011] TC 01504 (UKFTT)

Case F31 (1983) 6 NZTC 59,712 (TRA)

Case G8 (1985) 7 NZTC 1,021 (TRA)

Case J2 (1987) 9 NZTC 1,004 (TRA)

Case L89 (1989) 11 NZTC 1,508 (TRA)

Case U29 (2000) 19 NZTC 9,273 (TRA)

CIR v Mitchell (1986) 8 NZTC 5,181 (HC)

Commerce Commission v Fonterra Co-operative Group Ltd [2007] NZSC 36

Grieve v CIR [1984] 1 NZLR 101 (CA)

McGrath v CIR (1987) 9 NZTC 6,074 (HC)

Slater v CIR (1996) 17 NZTC 12,453 (HC)

Willis (H.M. Inspector of Taxes) v Peeters Picture Frames Limited [1983] STC 453 (NICA)

Legislative References

Income Tax Act 2007, ss GB 3BA, GB 3BAB, GB 3BAC, subparts IA (s IA 5), IB (ss IB 1 to IB 5), s IP 3B, s YA 1 ("business, "land").

Legislation Act 2019, s 10

Income and Corporation Taxes Act 1970 (UK), s 483(1)(a)

Related Rulings/Statements

"IS 21/04 Income tax and GST – deductions for businesses disrupted by the COVID-19 pandemic", *Tax Information Bulletin* Vol 33, No 9 (October 2021): 8.

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.