

INTERPRETATION STATEMENT: IS 20/03

INCOME TAX – SECTIONS GB 3B AND GB 4 OF THE INCOME TAX ACT 2007 – TEMPORARY LOSS CARRY-BACK REGIME

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

Contents

Summary	1
Introduction	2
Relevant legislation	3
Meaning of an “arrangement”	4
Arrangement may involve more than one transaction or document	5
Arrangement includes “all steps and transactions by which it is carried into effect”	5
Other aspects of an arrangement	6
Shares are “subject to” an arrangement, including “an arrangement directly or indirectly altering rights”	6
Arrangement “allows” the company to “meet” the relevant “requirements”	7
Meaning of a “purpose”	7
“Defeat the intent and application”	8
Examples	11
Example 1.....	12
Example 2.....	12
Example 3.....	14
Example 4.....	14
Appendix: Other relevant legislative provisions	16
References	19

Summary

1. The focus of this statement is to set out the Commissioner’s view of the application of the specific anti-avoidance provisions (ss GB 3B and GB 4) relevant to the temporary loss carry-back regime (s IZ 8). The regime allows a business to carry-back losses to a prior income year and receive a refund of tax paid.
2. The specific anti-avoidance provisions require:
 - that a company share is “subject to an arrangement” (which includes “an arrangement directly or indirectly altering rights attached to the shares”);
 - the arrangement “allows” the relevant company “to meet the requirements” of the temporary loss carry-back regime; and
 - a “purpose” of the arrangement is “to defeat the intent and application” of the regime.
3. A share will be “subject to an arrangement” if the share or the rights attached to the share are the subject matter of the arrangement. An “arrangement”

embraces all kinds of concerted action by which persons may arrange their affairs for a particular purpose or to produce a particular effect. It may involve more than one transaction or document and includes all steps and transactions by which it is carried into effect.

4. The arrangement must “allow” (ie, permit or enable) a company to obtain or maintain compliance with the ownership continuity or ownership commonality requirements during the relevant period, as required by s IZ 8.
5. If, objectively determined, the effect of the arrangement is that it defeats the intent and application of the temporary loss carry-back regime, then that will be a “purpose” of the arrangement.
6. The temporary loss carry-back regime concerns the treatment and use of tax losses. In general terms, rules around the use of tax losses are intended to ensure that the economic benefit of tax losses can only be obtained by the same people who effectively bore the direct economic burden of the losses.
7. The Commissioner considers that the test as to whether an arrangement “defeats the intent and application” of the temporary loss carry-back regime is, in effect, the same test as the parliamentary contemplation test under the general anti-avoidance provision (s BG 1), as set out by the Supreme Court in *Ben Nevis Forestry Ventures Ltd v CIR* [2008] NZSC 115. Both tests are aimed at arrangements that in legal substance satisfy the requirements of a particular provision or regime, but when viewed in a commercial and realistic way, make use of (or circumvent) the provision or regime in a manner that is inconsistent with the provision or regime’s purpose.

Introduction

8. The COVID-19 Response (Taxation and Other Regulatory Urgent Measures) Act 2020 introduces a temporary loss carry-back regime into the Income Tax Act 2007. This regime was introduced as part of a range of business tax changes in response to the economic impact of the COVID-19 pandemic.¹
9. The temporary loss carry-back regime enables a person who has taxable income in the 2018–19 or 2019–20 income year and anticipates a net loss in the next income year to make an election to reduce the amount of the net loss and also reduce the amount of the person’s taxable income in the earlier year by the same amount.
10. The primary rule is in the new s IZ 8 (election that amount of net loss for the 2019-20 or 2020-21 income year be tax loss in preceding income year), with specific anti-avoidance rules in the new s GB 3B (arrangements for carrying back net losses: companies) and the amended s GB 4 (arrangements for grouping tax losses: companies).

¹ For more details of the regime, see “COVID-19 Response (Taxation and Other Regulatory Urgent Measures) Act 2020, *A special report*” (Policy and Strategy, Inland Revenue, June 2020).

11. This interpretation statement considers the potential application of those specific anti-avoidance provisions to the temporary regime.
12. The statement does not consider the potential for a “market value circumstance” (as defined in s YA 1) to exist or the potential application of the general anti-avoidance provisions (ss BG 1 and GA 1). Both these matters would need to be borne in mind if the application of the temporary loss carry-back regime is being considered.

Relevant legislation

13. Section GB 3B states:

GB 3B Arrangements for carrying back net losses: companies

When this section applies

- (1) This section applies when—
 - (a) a share in a company (the **loss company**) or another company has been subject to an arrangement, including an arrangement directly or indirectly altering rights attached to the shares; and
 - (b) the arrangement allows the loss company to meet the requirements of section IZ 8 (Election to use net loss for 2019–20 or 2020–21 year as tax loss in preceding year); and
 - (c) a purpose of the arrangement is to defeat the intent and application of section IZ 8.

Company treated as not meeting requirements

- (2) The loss company is treated as not meeting the requirements of section IZ 8 in relation to the shares.

14. Section GB 4 states:

GB 4 Arrangements for grouping tax losses: companies

When this section applies

- (1) This section applies when—
 - (a) a share in a company (the **offset company**) or another company has been subject to an arrangement, including an arrangement directly or indirectly altering rights attached to the shares; and
 - (b) the arrangement allows the offset company to meet the requirements of subparts IC and IP, and sections IZ 7 and IZ 8 (which relate to the use of tax losses by group companies), as applicable; and
 - (c) a purpose of the arrangement is to defeat the intent and application of those provisions.

Company treated as not meeting requirements

- (2) The offset company is treated as not meeting the requirements of subparts IC and IP and sections IZ 7 and IZ 8, as applicable, in relation to the share.

15. Section IZ 8 is reproduced in the appendix to this statement.
16. In summary, for current purposes, ss GB 3B and GB 4 each have the following three requirements:
 - A share in the relevant company is “subject to an arrangement” (which includes “an arrangement directly or indirectly altering rights attached to the shares”).
 - The arrangement “allows” the relevant company “to meet the requirements” of the temporary loss carry-back regime.
 - A “purpose” of the arrangement is “to defeat the intent and application” of the temporary loss carry-back regime.

Meaning of an “arrangement”

17. The first requirement of ss GB 3B and GB 4 is that there is an “arrangement”. An arrangement is defined in s YA 1 as follows:

arrangement means an agreement, contract, plan, or understanding, whether enforceable or unenforceable, including all steps and transactions by which it is carried into effect

18. The definition of arrangement provides for varying degrees of formality and enforceability. For example, an arrangement may be:
 - a legally binding contract;
 - an agreement or plan that may or may not be legally binding;
 - an understanding that may or may not be legally binding; or
 - a contract that is not enforceable at law due to public policy, contractual incapacity or illegality.
19. The courts have considered the predecessor definitions of arrangement to that in s YA 1, particularly in the context of the general anti-avoidance provision. They described an arrangement as embracing all kinds of concerted action by which persons may arrange their affairs for a particular purpose or to produce a particular effect.
20. For example, in the Court of Appeal, Richardson P stated in *CIR v BNZ Investments Ltd* [2002] 1 NZLR 450:

[45] **The words contract, agreement, plan and understanding appear to be in descending order of formality.** A contract is more formal than an agreement, and in ordinary usage is usually written while an agreement is generally more formal than a plan, and a plan more formal or more structured than an understanding. **And it is accepted in the definition of arrangement that the contract, agreement, plan or understanding need not be enforceable.** Section 99 thus contemplates arrangements which are binding only in honour.

[46] In *Jaques v Federal Commissioner of Taxation* (1924) 34 CLR 328 at p 359 Isaacs J said that arrangement in s 260 meant an arrangement which was in the nature of a bargain but which might not legally or formally amount to a contract or an agreement. And in *Bell v Federal Commissioner of Taxation* (1953) 87 CLR 548 at p 573, **the High Court of Australia described arrangement as extending beyond contracts and agreements “so as to embrace all kinds of concerted action by**

which persons may arrange their affairs for a particular purpose or so as to produce a particular effect". [Emphasis added]

21. Richardson P was considering a previous definition of arrangement that listed the types of arrangement in descending order of formality. The current definition lists the same types of arrangement alphabetically, so that "agreement" comes before "contract". Despite this slight difference, Richardson P's point that the definition provides for varying degrees of formality and enforceability remains relevant.

Arrangement may involve more than one transaction or document

22. An arrangement may involve more than one transaction or document. Whether two or more transactions or documents together constitute an arrangement is a matter of fact (*Peterson v CIR* [2005] UKPC 5 at [33]). This determination requires consideration of the nature and extent of the relationship between the transactions or documents.
23. For example, in *CIR v Europa Oil (NZ) Ltd* [1971] NZLR 641 at 651, the Privy Council considered that six agreements constituted a single agreement because they were "far too close, and far too carefully worked out" to isolate and treat as "a series of independent bargains". The Privy Council considered an interdependence existed between the agreements because:
- they were made on the same date and some of them contained references to the other agreements;
 - they indicated that one party never intended to bind itself without entering into the other agreements; and
 - the effect of one of the agreements was to enable one party to sue for any breach of the other agreements.
24. In determining whether transactions and / or documents are part of an arrangement, the courts generally ask whether:
- the transactions or documents are:
 - sufficiently interrelated or interdependent (or both);
 - part of an overall plan to obtain a particular objective or outcome; or
 - there is prior planned linking or sequencing (or both) of the documents or transactions.
25. However, a mere sequence of events is not sufficient to constitute an arrangement (*AMP Life v CIR* (2000) 19 NZTC 15,940 (HC) at [125]). As mentioned, an arrangement requires an overall plan or some prior planned linking or sequencing (or both) of transactions or documents.

Arrangement includes "all steps and transactions by which it is carried into effect"

26. An arrangement, as defined, includes "all steps and transactions by which it is carried into effect". The words "including all steps and transactions by which it is carried into effect" reflect that an "agreement, contract, plan, or understanding" may not describe all the practical steps and transactions needed to carry out an arrangement.

27. Therefore, the definition makes clear that an arrangement includes the various actions undertaken to carry the arrangement into effect even if the actions are not themselves an “agreement, contract, plan, or understanding”.
28. This interpretation is consistent with *CIR v Penny* [2010] NZCA 2,310 where Randerson J stated:

[78] I am satisfied that an “arrangement” is not limited to a specific transaction or agreement but may embrace a series of decisions and steps taken which together evidence and constitute an agreement, plan or understanding. Any such arrangement may be continued in each of the income years in question or may be varied from year to year.

Other aspects of an arrangement

29. Other aspects of an arrangement include the following:
- An arrangement is defined to include a “plan”, which could involve a single person (*Russell v CIR (No 2)* (2010) 24 NZTC 24,463 (HC) (footnote 33 at [101]) and *Russell v CIR* [2012] NZCA 128 (at [54])).
 - An arrangement does not require a consensus or a meeting of minds of two or more persons so a taxpayer could be party to an “arrangement” even if they are not consciously involved in, or aware of, the details (see: *Peterson v CIR* [2005] UKPC 5 (PC) at [34]).
 - An arrangement may consist of more than one agreement, contract, plan or understanding, so an agreement, contract, plan or understanding may be part of a wider arrangement as well as being part of a separate narrower arrangement.
 - An arrangement includes steps and transactions that are entered into or carried out outside New Zealand (*BNZ Investments Ltd v CIR* (2000) 19 NZTC 15,732 (HC) at [123]).

Shares are “subject to” an arrangement, including “an arrangement directly or indirectly altering rights”

30. For ss GB 3B and GB 4 to apply, the shares in the relevant company (that is, the loss company, the offset company or another company) must be “subject to” an arrangement. A share will be subject to an arrangement if the share is the subject matter of the arrangement, meaning that the agreement, contract, plan or understanding concerns the share or the rights attached to the share.
31. Sections GB 3B(1)(a) and GB 4(1)(a) include “an arrangement directly or indirectly altering rights attached to the shares” as a type of arrangement that may be caught by the provisions. However, the alteration of rights is not a requirement of the provisions, and other types of arrangements concerning shares may be subject to the sections.

Arrangement “allows” the company to “meet” the relevant “requirements”

32. Sections GB 3B(1)(b) and GB 4(1)(b) require that the arrangement “allows” the loss company to “meet” the requirements of s IZ 8. Section IZ 8 contains the requirements for persons to make an election to use the temporary loss carry-back regime. In brief, the relevant requirements of s IZ 8 for the purposes of ss GB 3B(1)(b) and GB 4(1)(b) are the 49% share ownership continuity requirement and the 66% ownership commonality requirement.
33. The ordinary meaning of the word “allow” (and “allows”) includes permitting something to happen. The Court of Appeal has stated that the meaning of “allow” can vary according to context (*McKnight v NZ Biogas Industries Ltd* [1994] NZRMA 258 (CA)). In the context of ss GB 3B(1)(b) and GB 4(1)(b), the arrangement must permit or enable a company to obtain or maintain compliance with the ownership continuity or ownership commonality requirements during the relevant period (as required by s IZ 8).

Meaning of a “purpose”

34. Sections GB 3B(1)(c) and GB 4(1)(c) refer to “a purpose” of the arrangement. The section does not require that the purpose to defeat the intent and application of s IZ 8 be a dominant or main purpose, any such purpose will suffice. However, the purpose of the arrangement must be to defeat the intent and application of s IZ 8, and not simply to enable the company to meet the requirements of that provision.
35. The way in which a purpose test is to be applied and the factors that are relevant in ascertaining purpose depend on the statutory context (*CIR v Haenga* (1985) 7 NZTC 5,198 (CA)).
36. In an avoidance context, the courts have held that the “purpose or effect” of an arrangement is determined objectively and the motives or intentions of the parties are not relevant. The Privy Council in *Ashton v CIR* [1975] 2 NZLR 717 (PC) agreed with the earlier Privy Council decision in *Newton v Commissioner of Taxation* [1958] AC 450, [1958] 2 All ER 759, stating at 721:

In *Newton v Commissioner of Taxation* [1958] AC 450; [1958] 2 All ER 759 the Privy Council had to consider s 260 of the Commonwealth of Australia Income Tax and Social Services Contribution Assessment Act 1936–1951, a section very similar to s 108. In that case Lord Denning delivering the judgment of the Board said:

“The word ‘purpose’ means, not motive but the effect which it is sought to achieve — the end in view. The word ‘effect’ means the end accomplished or achieved. The whole set of words denotes concerted action to an end — the end of avoiding tax” (ibid, 465; 763).

And:

“... the section is not concerned with the motives of individuals. It is not concerned with their desire to avoid tax, but only with the means which they employ to do it. It affects every ‘contract, agreement or arrangement’ (which their Lordships will henceforward refer to compendiously as ‘arrangement’) which has the purpose or effect of avoiding tax. In applying the section you must, by the very words of it, look at the arrangement itself and see which is its effect — which it does — irrespective of the motives of the persons who made it.

Williams J put it well when he said: ‘The purpose of a contract, agreement or arrangement must be what it is intended to effect and that intention must be ascertained from its terms. Those terms may be oral or written or may have to be inferred from the circumstances but, when they have been ascertained, their purpose must be what they effect’ ([1958] AC 450, 465).

These observations of Lord Denning in relation to s 260 of the Australian Act are equally applicable to s 108.

37. Similarly, in *Glenharrow Holdings Ltd v CIR* [2008] NZSC 116, [2009] 2 NZLR 359 (SC), the following was stated:

[35] ... Secondly, the Commissioner must have been properly satisfied that the arrangement was entered into between the parties to it to defeat the intent and application of the Act or any provision of the Act. **This does not mean that the Commissioner must have been satisfied that the parties subjectively had that defeating purposes**, i.e that they were consciously trying to achieve the end of defeating the intent and application of the Act. ...

[36] A natural and sensible reading of s 76, as it stood prior to 2000, is to read it as requiring the Commissioner to be satisfied that an arrangement has been entered into between persons “so as to” defeat the intent and application of the Act or any provision of the Act. **That requires the Commissioner and the Court to ask what objectively was the purpose of the arrangement, which in turn requires examination of the effect of the arrangement.** Section 76, even in its pre-2000 version, therefore requires an examination of the purpose or effect of the arrangement, and in this respect the current version of the section has merely stated expressly what was implicit in the former version.

...

[38] ... the general anti avoidance provision was concerned not with the purpose of the parties, but with the purpose of the arrangement. That is a crucial distinction. Once you put the purpose of the parties to one side and seek by objective examination to find the purpose of the arrangement, you must necessarily do that by considering the effect which the arrangement has had — what it has achieved — and then, **by working backwards as it were from the effect, you are able to determine what objectively the arrangement must be taken to have had as its purpose.** That approach is inevitable once any subjective purpose or motive is ruled out of contention, as the authorities say it must be. [Emphasis added]

38. While these cases relate to the general anti-avoidance provisions, the Commissioner considers that the same principles apply to ss GB 3B and GB 4. This means that if the effect an arrangement, determined objectively, is to defeat the intent and application of the temporary loss carry-back regime, then that will be the purpose of the arrangement.

“Defeat the intent and application”

39. Sections GB 3B(1)(c) and GB 4(1)(c) require that a purpose of the arrangement must be to “defeat the intent and application” of the temporary loss-carry back regime.
40. The courts have considered the meaning of provisions with similar wording in *Auckland Harbour Board v CIR* (2001) 20 NZTC 17,008 (PC), *Ch’elle Properties (NZ) Ltd v CIR* (2004) 21 NZTC 18,618 (HC), *Ch’elle Properties (NZ) Ltd v CIR* (2007) 23 NZTC 21,442 (CA) and *Glenharrow*.

41. *Auckland Harbour Board* concerned the application of s 64J(1) of the Income Tax Act 1976 (now s GB 21), which stated:

64J Non-market dispositions

- (1) Where the Commissioner, having regard to any connection between the parties to the issue or transfer of a financial arrangement and to any other relevant circumstances is satisfied that the parties were dealing with each other in relation to the issue or transfer in a manner that **has the effect of defeating the intent and application of sections 64B to 64M of this Act**, the Commissioner may, for the purposes of calculating the assessable income or expenditure of the parties under section 64C or section 64D or section 64F or section 64I of this Act, deem the consideration for the issue or transfer to be equal to the consideration that might reasonably be expected for the issue or transfer if the parties to the issue or transfer were independent parties dealing at arm's length with each other in relation to the issue or transfer. [Emphasis added]

42. In *Auckland Harbour Board*, Lord Hoffmann made the following comments in relation to s 64J(1) of the Income Tax Act 1976:

[11] ... The section appears to their Lordships to contemplate that the circumstances which justify its application will be specific to a particular transaction, arising out of the relationship between the parties and other relevant circumstances. In this respect it is similar to other anti-avoidance provisions such as s 99. Their Lordships do not of course suggest that the two sections necessarily cover the same ground, but what they have in common is that they are **generally speaking aimed at transactions which in commercial terms fall within the charge to tax but have been, intentionally or otherwise, structured in such a way that on a purely juristic analysis they do not**. This is what is meant by defeating the intention and application of the statute. [Emphasis added]

43. In summary, Lord Hoffmann considered s 64J(1) of the Income Tax Act 1976 to be in the nature of an anti-avoidance provision, which applied where a transaction fell within the charge to tax in commercial terms but had been structured in such a way that on a purely juristic analysis it did not.

44. *Ch'elle* (HC and CA) was concerned with s 76 of the Goods and Services Tax Act 1985 (as it applied before 10 October 2000):

76 Agreement to defeat the intention and application of Act to be void

- (1) Notwithstanding anything in this Act, where the Commissioner is satisfied that an arrangement has been entered into between persons **to defeat the intent and application of this Act, or of any provision of this Act**, the Commissioner shall treat the arrangement as void for the purposes of this Act and shall adjust the amount of tax payable by any registered person (or refundable to that person by the Commissioner) who is affected by the arrangement, whether or not that registered person is a party to it, in such manner as the Commissioner considers appropriate so as to counteract any tax advantage obtained by that registered person from or under that arrangement. [Emphasis added]

45. In *Ch'elle* (HC), Rodney Hansen J made the following comments in relation to s 76 of the Goods and Services Tax Act 1985 at [39]:

Section 76 calls for a more broadly based enquiry than is required to establish technical compliance. It is whether the arrangement has been entered into "to defeat the intent and application of the Act". I agree with Ms Ellis that this goes beyond the technical legality of the constituent parts of the arrangement. It requires the arrangement to be assessed by reference to the principles which underly the Act.

46. In *Ch'elle* (CA), Robertson J upheld the High Court's judgment and confirmed at [31] that:

[i]n order to assess whether s 76 [of the Goods and Services Tax Act 1985] is triggered it is necessary to assess the scheme and purpose of the GST Act.

He also stated at [29]:

As with all general anti-avoidance provisions, its purpose is to strike down arrangements that frustrate the taxing regime, despite the arrangement's technical compliance with substantive taxing provisions.

47. *Glenharrow* concerned s 76 of the Goods and Services Tax Act 1985 (as it applied before 10 October 2000). In the Supreme Court decision, Blanchard J stated:

The operation of s 76

...

[34] In order for the Commissioner to be able to invoke s 76 he must be satisfied that the arrangement which he wishes to treat as void has been "entered into between persons to defeat the intent and application" of the GST Act or of any provision of the Act. Consistent with the approach to interpretation of General Anti-Avoidance Rules (GAARs) in the income tax context, and as foreshadowed in the preceding paragraph, **this determination requires an assessment that goes beyond the technical legality of the constituent parts of the arrangement.** The onus is on the taxpayer to show that the Commissioner could not properly have been satisfied in terms of the section.

...

The intent and application of the Act

[40] The application to an arrangement of tax legislation such as s 76 of the GST Act is concerned with the "aim or end in view" of the arrangement. It is to be objectively assessed. **And the assessment will principally be a matter of inference from the arrangement and its effect.** The purpose of an arrangement will be deduced from the arrangement itself and its effect. **The intention of the Act will be defeated if an arrangement has been structured to enable the avoidance of output tax, or the obtaining of an input deduction in circumstances where that consequence is outside the purpose and contemplation of the relevant statutory provisions.** Lord Hoffmann in *C of IR v Auckland Harbour Board* (2001) 20 NZTC 17,008 (PC) commented that, generally speaking, GAARs were:

"aimed at transactions which in commercial terms fall within the charge to tax but have been, intentionally or otherwise, structured in such a way that on a purely juristic analysis they do not. This is what is meant by defeating the intention and application of the statute.

An arrangement of this kind is not in accordance with the overall purpose of the Act because it produces a "tax advantage" not within the contemplation of the statute. [Emphasis added]

48. Having regard to principles identified in *Auckland Harbour Board*, *Ch'elle*, and *Glenharrow*, the Commissioner considers the test as to whether an arrangement "defeats the intent and application" of a particular provision under a specific anti-avoidance provision such as s GB 3B or s GB 4 is in effect the same test as the parliamentary contemplation test under the general anti-avoidance provision (s BG 1), as set out by the Supreme Court in *Ben Nevis Forestry Ventures Ltd v CIR* [2008] NZSC 115. Both tests are aimed at transactions and arrangements that in juristic or legal terms (that is, in legal substance) satisfy the requirements of the particular provision but, when viewed in terms of their commercial and

economic reality, make use of (or circumvent) the provision in a manner that is inconsistent with the purpose of that provision.

49. This means that when applying ss GB 3B and GB 4, it is necessary to consider:
- the purpose of the temporary loss carry-back regime; and
 - whether the facts of the arrangement have the consequence (effect) that the arrangement's purpose is inconsistent with the purpose of those provisions.
50. As mentioned, the temporary loss carry-back regime was introduced as a temporary response to the economic impact of the COVID-19 pandemic. The intent and application of the regime (and the application of ss GB 3B and GB 4) must be interpreted in light of the reason for its introduction.
51. The temporary loss carry-back regime enables a person who has taxable income in the 2018–19 or 2019–20 income year and anticipates a net loss in the next income year to make an election to reduce the amount of the net loss and also reduce the amount of the person's taxable income in the earlier year by the same amount. The temporary loss carry-back regime is intended to provide fast cash-flow relief for businesses that are in a loss position during the period affected by COVID-19.
52. The temporary loss carry-back regime is one of a number of provisions in the Act that relate to the treatment and use of tax losses. In general terms, as they currently apply, those rules are intended to ensure that the economic benefit of tax losses can only be obtained by the same people who effectively bore the economic burden of the losses. The loss carry-back regime does not override the current rules that prevent the use of losses where ownership changes, albeit those rules apply to compare the loss year to the (earlier) profit year. The 49% ownership continuity requirement and the 66% ownership commonality requirement for grouping losses currently apply to prevent the use of losses by persons who were not connected in the way contemplated by the legislation with the loss-making business when the losses were incurred. The availability of relief under the temporary loss carry-back regime is subject to the same tests during the "offset ownership period" (as defined in s IZ 8(1)).
53. The intent and application of the temporary loss carry-back regime will be defeated by an arrangement that allows losses (and relief) to be claimed by businesses where, viewing the arrangement in terms of its commercial and economic reality, the required connection has not been or will not be maintained when comparing the loss year to the profit year.

Examples

54. The following examples are intended to illustrate the general approach to the application of ss GB 3B and GB 4 only. As mentioned at [12], this statement, including the following examples, do not consider whether a "market value circumstance" (as defined in s YA 1) exists or whether the general anti-avoidance provisions (ss BG 1 and GA 1) would potentially apply.

Example 1

55. A Ltd's taxable income in the 2019–20 income year was \$2 million. By August 2020, it becomes clear to the company's directors that, due to the impacts of COVID-19 on the company's trading activities, A Ltd is likely to have significant tax losses for the 2020–21 income year. The losses for the part-year to August 2020 are already \$1 million. It is also clear to the directors that A Ltd needs a significant injection of funds to continue trading. The company directors identify a potential new investor (B Ltd).
56. The shares in A Ltd are 100% owned by Mr and Mrs X. After a period of negotiation, the directors of A Ltd and Mr and Mrs X conclude a memorandum of understanding with B Ltd under which B Ltd will provide the necessary debt financing in addition to acquiring a controlling interest of 60% of the ordinary shares in A Ltd. Mr and Mrs X will continue to hold the remaining 40% of the shares after the transaction is completed.
57. The parties realise that one effect of implementing this arrangement in August 2020 is that A Ltd would breach the continuity of ownership rules and therefore would not satisfy the requirements to permit an election under s IZ 8. This means that any losses incurred for the remaining part of the 2020–21 income year would be unable to be carried back. A Ltd's ability to carry losses back to the 2019–20 income year under s IZ 8 and the consequent tax refund could be maximised if any change in ownership does not occur during the 2020–21 income year.
58. Accordingly, when the arrangement is implemented in August 2020:
- B Ltd unconditionally agrees to acquire 60% of the ordinary shares of A Ltd as at the end of the 2020–21 income year (1 April 2021) at the same price as originally contemplated in the memorandum of understanding but with an adjustment of 50% of the tax relief arising from any additional tax losses available to A Ltd attributable to the period 1 August 2020 to 31 March 2021;
 - B Ltd agrees to provide the capital injection immediately by way of a loan on interest-only terms and at market rates in return for debentures issued by A Ltd with security over the assets of the company;
 - the loan principal advanced is the same amount of consideration B Ltd is required to pay for the shares under the agreement for sale and purchase of 60% of the shares in A Ltd;
 - the loan arrangement is made on usual commercial terms, including lender protection:
 - to satisfy the share purchase price, B Ltd will assign the loan to Mr and Mrs X;
 - the directors of A Ltd resolve immediately to appoint to the board a director nominated by B Ltd; and
 - the shareholders of A Ltd, subject to the sale and purchase of the shares agreement with B Ltd, immediately enter into an agreement with B Ltd in which they agree not to exercise their shareholder decision-making rights in a way contrary to the directions and interests of B Ltd.

59. A Ltd's net loss for the 2020–21 income year is \$1.8 million. A Ltd elects to apply s IZ 8 to carry the loss back to the 2019–20 income year.
60. This arrangement would be subject to s GB 3B. A Ltd is treated as not meeting the requirements of s IZ 8 from the date of the arrangement (while the losses up to the date of the arrangement may still meet those requirements). The shares in A Ltd are subject to an arrangement that enables the company to continue to meet the requirements of s IZ 8 for the entire 2020–21 income year. A purpose of the arrangement is to defeat the intent and application of s IZ 8 by preserving the ability to carry back the full amount of A Ltd's loss for that income year, while the commercial and economic reality of the arrangement is that B Ltd has immediately acquired a controlling interest in A Ltd as though the share sale had already taken place. This defeats the intent and application of the temporary loss carry-back regime.

Example 2

61. ABC Co and XYZ Co are wholly-owned subsidiaries of P Ltd and each operates a popular tourist attraction in Queenstown.
62. While both attractions have been operating profitably, P Ltd has been seeking a purchaser for ABC Co for some time. After extensive negotiations with Q Ltd, P Ltd and Q Ltd entered into a memorandum of understanding for the sale of the ABC Co shares in February 2020. The memorandum provided for the sale to take place on 1 June 2020 for a fixed price, determined by reference to an independent valuation undertaken in January 2020.
63. The COVID-19 lockdown occurred before the terms of the sale agreement could be finalised and entered into, which resulted in further negotiations between the parties taking place in April 2020.
64. In the 2019–20 income year, ABC Co made a profit of \$1 million and XYZ Co made a profit of \$100,000. However, due to the ongoing impact of COVID-19 on their businesses, for the 2020–21 income year, ABC Co expects to make a small profit of \$50,000, while XYZ Co expects to make a substantial loss of (\$500,000).
65. P Ltd would like to reduce the amount of income tax payable by the group by offsetting XYZ Co's expected losses for the 2020–21 income year against ABC Co's income from the 2019–20 income year and take advantage of the newly introduced loss carry-back regime (net of ABC Co's \$50,000 profit). This would not be possible if the sale to Q Ltd takes place on the terms contemplated by the memorandum of understanding, as the commonality of ownership requirement would not be satisfied from 1 June 2020.
66. Q Ltd agrees to defer the acquisition of the shares in ABC Co until the start of the 2021–22 income year, but will take responsibility for the day to day management and operation of ABC Co's tourist attraction from 1 June 2020 under a management agreement that entitles Q Ltd to all proceeds from the operation after direct operating costs have been met. All other aspects of the memorandum of understanding, including the purchase price, are unchanged and the agreement for sale and purchase is entered into on 1 June 2020.

67. Section GB 4 applies to this arrangement. The shares in ABC Co are subject to an arrangement that allows it to continue to meet the requirements of s IZ 8 for the entire 2020–21 income year. A purpose of the arrangement is to preserve the ability to carry back the full amount of XYZ Co’s 2020–21 loss. While a share sale with deferred settlement is not unusual, the specific agreement between the parties here defeats the intent and application of the temporary loss carry-back regime. Therefore, ABC Co is treated as not satisfying the requirements of s IZ 8 from the date of the arrangement (1 June 2020).

Example 3

68. F Ltd’s taxable income in the 2019–20 income year was \$25 million. By July 2020, it is clear to the company’s directors that, due to the impacts of COVID-19 on F Ltd’s business, F Ltd is likely to have significant tax losses for the 2020–21 income year. The loss is estimated at over \$15 million. It is also clear to the directors that F Ltd needs a significant injection of funds to continue trading.
69. F Ltd’s bank (C Bank) is prepared to lend F Ltd additional debt funding on normal arm’s length, commercial terms. C Bank considers that F Ltd will be able to meet its obligations under the loan. However, due to uncertainty concerning the impact of COVID-19 on F Ltd’s business, C Bank requires that the shareholders of F Ltd provide security over their shares in F Ltd.
70. If the security is called on before the end of the 2020-21 income year, and C Bank acquires the shares there would be a loss of shareholder continuity under the current law, which would cause F Ltd to fail to meet the requirements of s IZ 8 and be unable to carry back any loss that occurs after that date. However, if C Bank enforces the security after the end of the 2020-21 income year, the loss carry-back is unaffected.
71. The shares of F Ltd are the subject of an arrangement. However, the purpose of the arrangement is to provide F Ltd with funding on commercial terms. The commercial and economic reality of the arrangement is that C Bank is a secured lender, lending to F Ltd on commercial terms. In the Commissioner’s view, defeating the intent and application of s IZ 8 or the temporary loss carry-back regime is not a purpose of the arrangement. Accordingly, s GB 3B would not apply to the arrangement. F Ltd would be entitled to make an election under s IZ 8 for the portion of its loss that arises after the funding from C Bank is drawn down.

Example 4

72. In the 2019–20 income year, P Ltd was a successful company with \$10 million of taxable income. P Ltd has two shareholders, X Ltd, who owns 40% of the ordinary shares, and Y Ltd, who owns 60%.
73. Due to the impact of COVID-19, P Ltd expects to have a significant loss (\$5 million) in the 2020–21 income year. P Ltd is also experiencing acute financial difficulty and requires a significant injection of cash to continue trading. X Ltd is in a position to provide that funding, but Y Ltd is not. The parties come to an agreement for X Ltd to provide P Ltd with additional funds in the form of a loan, with Y Ltd granting X Ltd a call option over 55% of the shares in P Ltd. The loan will be interest bearing and on arm’s-length commercial terms.

74. The call option will only be exercisable if P Ltd defaults under the loan from X Ltd. If the call option is exercised, X Ltd will hold 95% of the shares in P Ltd, and there will be a loss of shareholder continuity under the current law. This would cause P Ltd to fail to meet the requirements of s IZ 8 and be unable to carry back any loss that occurs after that date.
75. At the time the loan is entered into, neither party expects that the call option will be required to be exercised.
76. The shares of P Ltd are the subject of an arrangement. However, the purpose of the arrangement is to provide P Ltd with funding on commercial terms. The commercial and economic effect of the arrangement is that X Ltd is a secured lender, lending to P Ltd on commercial terms. In the Commissioner's view, defeating the intent and application of s IZ 8 or the temporary loss carry-back regime is not a purpose of the arrangement. Accordingly, s GB 3B would not apply to the arrangement. P Ltd would be entitled to make an election under s IZ 8 for the portion of its loss arising after the loan is entered into.

Appendix: Other relevant legislative provisions

77. Section IZ 8 states:

IZ 8 Election to use net loss for 2019–20 or 2020–21 year as tax loss in preceding year

Terms used in this section

- (1) This section provides that a person who has taxable income in the 2018–19 or 2019–20 income year and a net loss in the following income year may choose to reduce the taxable income in the first year by an amount, which is treated as being an available tax loss that can be used in the first income year, and subtracting the same amount from the net loss that would otherwise be available in the second income year, subject to restrictions that are expressed in terms of—
- (a) the **offset years**, which refers to the period of 2 years that is affected by the election and begins with either the 2018–19 or the 2019–20 income year;
 - (b) the **taxable income year**, which refers to the first of the offset years;
 - (c) the **initial taxable income**, which refers to the amount of taxable income given by subsection (2)(a) for the person and the taxable income year;
 - (d) the **net loss year**, which refers to the second of the offset years;
 - (e) the **electd amount**, which refers to the amount by which an election under this section reduces both the initial taxable income and the net loss that, in the absence of the election, the person would have in the net loss year;
 - (f) the **offset ownership period**, which refers to the period in the offset years for which a person that is a company meets requirements relating to continuity of ownership for carrying forward loss balances from 1 tax year to the next;
 - (g) the **income ownership period**, which refers to the part of the offset ownership period that occurs in the taxable income year;
 - (h) the **loss ownership period**, which refers to the part of the offset ownership period that occurs in the net loss year;
 - (i) the **group loss excess**, which is the amount of the excess of net loss given by subsection (3)(b) for the members of a wholly-owned group of companies and the loss ownership period.

Who may make election under this section: general rule

- (2) A person, other than a person who is a member of a wholly-owned group of companies during the offset ownership period, may make an election under this section for the period consisting of 2 income years beginning with the 2018–19 or the 2019–2020 income year if,—
- (a) in the absence of an election under this section, the person would have an amount of taxable income remaining in the taxable income year after subtracting the total amount of charitable donations for which the person has a tax credit for the taxable year under subpart LD (Tax credits for gifts and donations); and
 - (b) in the absence of an election under this section, the person would have a net loss in the net loss year; and
 - (c) the person is not a qualifying individual, as defined in section 3(1) of the Tax Administration Act 1994, in the net loss year and is not a multi-rate PIE in the offset years; and
 - (d) when the person is a company, the person meets the requirements relating to continuity of ownership given by section IA 5 or IP 3 (which give the requirements for companies to carry forward loss balances) during the offset ownership period.

Who may make election under this section: rule for member of wholly-owned group

- (3) A person who is a member of a wholly-owned group of companies during the offset ownership period may make an election under this section for the offset years if,—
- (a) in the absence of an election under this section, the person would have a net loss in the net loss year; and
 - (b) in the absence of an election under this section, an excess of net loss would remain for the loss ownership period if the total amount of the net loss of the person and the other group members were reduced by the total amount of the net income of the person and the other group members for which the other group members have not used non-refundable tax credits to meet income tax liabilities; and
 - (c) the person meets the requirements relating to continuity of ownership given by section IA 5 or IP 3 during the offset ownership period.

Making election

- (4) The person makes the election by including the elected amount, which must not exceed the amount given for the person by subsection (5), (6), or (7), as an available tax loss in calculating the person's taxable income for the taxable income year, in—
- (a) a return of income for the taxable income year; or
 - (b) a request that the Commissioner amend under section 113 of the Tax Administration Act 1994 the assessment for the taxable income year.

Effect of election: person other than company

- (5) If the person is not a company, the person's net loss for the net loss year is reduced, and the person's available tax loss for the taxable income year is increased, by an amount that is the smallest of—
- (a) the initial taxable income referred to in subsection (2)(a):
 - (b) the amount of the net loss referred to in subsection (2)(b):
 - (c) the elected amount.

Effect of election: company not in group

- (6) If the person is a company, other than a company that is a member of a group of companies at a time in the offset ownership period, the person's net loss for the net loss year is reduced, and the person's available tax loss for the taxable income year is increased, by an amount that is the smallest of—
- (a) the initial taxable income referred to in subsection (2)(a):
 - (b) the amount of the net income of the person for the income ownership period:
 - (c) the amount of the net loss referred to in subsection (2)(b):
 - (d) the amount of the net loss of the person for the loss ownership period:
 - (e) the elected amount.

Effect of election: member of group of companies

- (7) If the person is a member of a group of companies at a time in the offset ownership period, the person's net loss for the loss ownership period is reduced, and the person's available tax loss for the income ownership period is increased, by an amount that is the smallest of—
- (a) the total amount of—
 - (i) the smaller of the initial taxable income referred to in subsection (2)(a) and the net income of the person for the income ownership period:
 - (ii) the part of the elected amount that is made available under subparts IC and IP (which relate to the use and grouping of tax

losses) to other members of the group of companies in the taxable income year:

- (b) if the person is a member of a wholly-owned group in the loss ownership period, the group loss excess referred to in subsection (3)(b) reduced by the total amount of the reductions in net loss for the period for the other members of the group from elections under this section:
- (c) the elected amount.

Application of subparts IC and IP to amounts made available to members of group

- (8) In the application of subparts IC and IP to the making available by a person, to another member of a group of companies, of an amount of available tax loss arising for the person under subsection (7),—
 - (a) the amount of available tax loss that exceeds the person's initial taxable income is a tax loss for the taxable income year for the purposes of section IC 1 (Company A making tax loss available to company B):
 - (b) the commonality period referred to in section IC 6 (Common ownership for period) is the period consisting of the offset years:
 - (c) the requirements in section IP 4(4) and section IP 5 (which relate to breaches of continuity or commonality requirements) are not applied:
 - (d) the requirements in section IP 4(2)(a), (ab), and (c) (Breach in income year in which tax loss component arises) are replaced by the requirements given by subsection (9).

Replacement requirements in applying section IP 4(2)

- (9) The replacement requirements in section IP 4(2) are—
 - (a) the net loss giving rise to the available tax loss arises in the portion of the loss ownership period that is included in the common span; and
 - (b) the amount of the available tax loss is no more than the net income that the group company derives in the portion of the income ownership period that is included in the common span; and
 - (c) the person and the group company provide the Commissioner with adequate financial statements under section IP 6 (Financial statements required).

When allocation of net loss effective

- (10) The increase in the person's available tax loss for the taxable income year is not effective until the person—
 - (a) files a return of income for the taxable income year that includes a figure for the elected amount or an updated figure replacing a figure for the elected amount; or
 - (b) makes a request that the Commissioner amend under section 113 of the Tax Administration Act 1994 the assessment for the taxable income year based on a figure or an updated figure for the elected amount.

Requests required for some amended assessments

- (11) A person who makes an election under this section must make a request that the Commissioner amend under section 113 of the Tax Administration Act 1994 the assessment for the taxable income year if the elected amount used in the most recent assessment of that income year exceeds the amount permitted by this section in the return of income for the net loss year.

Accounting for part years in ownership continuity period

- (12) If the offset ownership period for a company includes a part, but not all, of an income year, the company must provide to the Commissioner adequate financial statements for the relevant part of the income year complying with the requirements of sections IP 3(2) and (4) (Continuity breach: tax loss components of companies carried forward) and IP 6.

References

Subject references

anti-avoidance provisions
arrangement
loss carry-back regime

Legislative references

COVID-19 Response (Taxation and Primary Industries Urgent Measures) Act 2020
Goods and Services Tax Act 1985, s 76
Income Tax Act 1976, s 64J(1)
Income Tax Act 2007, ss BG 1, GA 1, GB 3B, GB 4, GB 21, IZ 8, YA 1 ("arrangement")

Case references

AMP Life v CIR (2000) 19 NZTC 15,940 (HC)
Ashton v CIR [1975] 2 NZLR 717 (PC)
Auckland Harbour Board v CIR (2001) 20 NZTC 17,008 (PC)
Ben Nevis Forestry Ventures Ltd v CIR [2008] NZSC 115 (SC)

BNZ Investments Ltd v CIR (2000) 19 NZTC 15,732 (HC)
Ch'elle Properties (NZ) Ltd v CIR (2004) 21 NZTC 18,618 (HC)
Ch'elle Properties (NZ) Ltd v CIR (2007) 23 NZTC 21,442 (CA)
CIR v BNZ Investments Ltd [2002] 1 NZLR 450 (CA)
CIR v Europa Oil (NZ) Ltd [1971] NZLR 641 (PC)
CIR v Haenga (1985) 7 NZTC 5,198 (CA)
CIR v Penny [2010] NZCA 2,310
Glenharrow Holdings Ltd v CIR [2008] NZSC 116, [2009] 2 NZLR 359
McKnight v NZ Biogas Industries Ltd [1994] NZRMA 258 (CA)
Newton v Commissioner of Taxation [1958] AC 450; [1958] 2 All ER 759 (PC)
Peterson v CIR [2005] UKPC 5
Russell v CIR (No 2) (2010) 24 NZTC 24,463 (HC)
Russell v CIR [2012] NZCA 128