

## **Standard practice statement**

**SPS 20/02**

### **Loss offset elections between group companies**

#### **Introduction**

Standard practice statements describe how the Commissioner of Inland Revenue (the Commissioner) will exercise a statutory discretion or deal with practical issues arising out of the administration of the Inland Revenue Acts.

This Statement sets out certain practices that the Commissioner will accept for offsetting losses by election between group companies. It also sets out the consequences of specific events that can impact on a loss offset and how these should be addressed.

The Statement does not consider all questions relating to loss offsets within a group of companies and accordingly is not a fully comprehensive guide to Subpart IC of the Income Tax Act 2007.

All legislative references in this Statement refer to the Income Tax Act 2007, unless otherwise specified.

#### **Application**

This Statement applies from 12 February 2020 and replaces SPS 17/03 *Loss offset elections between group companies* published in *Tax Information Bulletin* Vol 30, No 1 (February 2018).

#### **Standard practice**

##### **Summary**

1. The purpose of the loss offset provisions is to allow those companies that incur losses to utilise those losses even where different entities are involved. This means that there is similarity in the tax treatment of a group of companies, each carrying on separate enterprises, as compared with a single company that carries on the same enterprises in separate divisions.
2. This Statement sets out the application of certain pre-requisites and other aspects of loss offset provisions in Subpart IC which allow loss offset elections to be made. It discusses the requirements for giving notice, the Commissioner's practice with respect to part-year losses and explains what should happen when the loss

company's loss or the profit company's net income is increased or reduced. It also sets out the requirements for there to be a valid election and/or subvention payment.

3. A loss company must be resident in New Zealand in terms of s IC 7. The loss company must have maintained a 49% continuity of ownership from the time of the loss to the time of the offset. The profit company(ies) and the loss company must have at least 66% common ownership. The amount of loss offset(s) will be limited to the amount of profit(s) in the profit company(ies). The amount must be fixed by the election in a manner that binds the electing company but need not be quantified in the election. Refer to [13] to [15] for more detail in this area.
4. The loss company must notify the Commissioner of an election for the loss offset and where applicable of a subvention payment within the timeframe under s IC 9. The election may be notified in a tax return or separately from the tax return. The Commissioner may agree to an extension of time for filing the election so long as the request for an extension of time is made and approved before an offset is made.

## Detailed discussion

5. Subpart IC provides for the sharing of losses between companies that are in the same group of companies. A company may make its tax loss available for subtraction from the net income of another group company.
6. There are two methods of sharing losses which may be used together. The first is for the loss company to notify an election in its tax return for the loss to be made available to the profit company. Any such election is irrevocable. That election must be notified to the Commissioner no later than the 31 March that follows the end of the loss company's year of offset, or within such further time as the Commissioner may allow: s IC 9(2).
7. Another method of sharing a loss is for the profit company to make a "subvention payment" to the loss company. A subvention payment made to the loss company is offset against the profit company's net income and reduces the loss company's available net losses. The payment to the loss company and notice to the Commissioner by the loss company of that payment must be made no later than the 31 March that follows the end of the loss company's year of offset, or within such further time as the Commissioner may allow: ss IC 9(1) and (2).
8. Previously the Commissioner took the view that a subvention payment required actual payment to be made. However, from December 2010 it is accepted that in the absence of any statutory definition of "payment" in the context of subvention payments, the following principles will apply:
  - a) The ordinary meaning requires a discharge of obligations between parties.
  - b) There are several ways in which an obligation may be discharged including payment in cash or its equivalent or by certain accounting entries.
  - c) Payment may be made by accounting entries where they cause a genuine crediting in the payee's account or set off a pre-existing obligation. Making a journal entry will not be generally sufficient to cause a "payment" unless there is a clear agreement between the parties that this will satisfy the obligation.

Consequently, in the subvention payment context, "payment" will be satisfied when the obligation under the subvention payment agreement has been discharged. The obligation can be discharged by an actual cash payment, cheque or bank transfer. Other methods of discharging an obligation can also amount to "payment". An

obligation will generally be discharged where the payee can no longer sue the payer for the payment. It should be noted that an accounting entry that merely records an intention to pay a subvention payment will not in itself amount to a "payment". Also, simply resolving to pay a subvention payment does not amount to creating an enforceable obligation.

### Example 1

A loss company has an obligation to pay a debt to a profit company for past purchases from the profit company. The profit company resolves to make a subvention payment to the loss company. The profit company and the loss company decide to allow the subvention payment to be applied in satisfaction of the loss company's past debt. An accounting entry is made to record this. The accounting entry is treated as the payment of the subvention payment.

9. As stated above, this Statement sets out the application of certain aspects of loss offset provisions in Subpart IC which allow loss offset elections to be made. It discusses the requirements for giving notice, the Commissioner's practice with respect to part year losses, and explains what should happen when the loss company's loss or the profit company's net income is increased or reduced. It also sets out the requirements for there to be a valid election. Where this statement discusses elections, it is equally referring to notices of subvention payments made.
10. The election may be included in the loss company's income tax return or made separately from the tax return. An election must be made by the latest time to file a loss company's income tax return. The Commissioner has discretion to accept a late election to offset losses beyond an agreed extension of time to file the return.
11. The Commissioner must approve the application to apply the discretion and agree to make the loss offset. The mere processing of the return and issuing the taxpayer's notice of assessment do not amount to an exercise of the discretion by the Commissioner to accept a late loss offset election.

### Prerequisites

12. Before a loss offset can proceed the following factors must be present.

#### *Loss company*

13. There must be a company with a tax loss for an income year or a loss balance carried forward. The loss company must have 49% continuity of ownership from the time the loss is incurred until the loss is offset: ss IA 5(2), (3) and (6).
14. The loss company for the commonality period under s IC 6(1) must be incorporated in New Zealand or be carrying on a business in New Zealand through a fixed establishment in New Zealand.
15. The loss company for the commonality period under s IC 6(1) must not be a dual resident company, that is, though resident in New Zealand it must not be:
  - treated under a double tax agreement as not being resident in New Zealand for the purposes of the double tax agreement, or
  - liable to income tax in another country by reason of domicile, residence or place of incorporation: s IC 7.

16. A qualifying company may only receive a loss offset from another qualifying company: s HA 22.

*Profit company*

17. There must be one or more profit companies in the same group of companies as the loss company and all companies must be in the same group of companies for the whole continuity period as defined in s IA 5(6). A group of companies must have at least 66% common ownership. Whether or not two companies form a group of companies is outside the scope of this Statement. More detailed guidance on common ownership can be found in the Interpretation Statement: *IS 13/02 Income tax – whether certain rights conferred by the Companies Act 1993 could give rise to a "shareholder decision-making right"*.<sup>1</sup>

*Amount of loss*

18. The amount of loss to be offset must not exceed the net income of the elected profit company for the tax year, or the total net income of all the elected profit companies. Nor can the amount of subvention payment that the profit company agrees to pay the loss company exceed the loss company's tax loss: s IC 8.

*A specific amount*

19. An election should refer to an amount that is capable of identification as a specific dollar amount. The amount must be fixed by the election in a manner that binds the loss company but need not be quantified in the notice of election. That is, a formula may be used where the result of applying that formula could be known at the time of the election. For instance, the election might provide that the tax loss to be offset is to be such an amount that would reduce the profit company's net income to nil.

**Example 2**

In a group consisting of two companies, it is found, once its accounts have been prepared, that Company A has a tax loss of \$10,000. It is anticipated that Company B will be in profit and that the amount of the net income will be about \$2,000, ie less than the amount of Company A's tax loss. However, Company B's accounts have still to be prepared as the accountants are waiting on further information from their clients. That information will be arriving in a few days. There is still time to file an election and the question is whether Company A can now elect to offset some of its loss up to the amount of the profit company's net income by using a formula.

This is permissible because:

- the Commissioner will be notified in time;
- the amount will be subsequently identified as a specific dollar amount;
- it does not matter that (even if the accounting firm could commit staff to the finalisation of the accounts) the net income cannot be ascertained with finality at the time of making the election;
- the amount to be offset is already fixed in that it is controlled by the formula.

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<sup>1</sup> This statement can be found at [www.ird.govt.nz](http://www.ird.govt.nz) (search keyword: "IS 13/02").

## The election

20. An election to offset the tax loss must be notified by the loss company. The loss company can give notice of election by:
- completing the appropriate boxes in the loss company's income tax return, or
  - completing the appropriate boxes in the loss company's e-filed income tax return, or
  - sending a separate notice to the Commissioner. These notices need to set out the names and IRD numbers of the relevant companies as well as the respective amounts (or formula for calculation of the amounts) of net loss to be offset.

### *Late elections and extensions of time for filing them*

21. An election must generally be made by 31 March in the year following the year of loss offset (that is, in the year to March 31 when the offset is elected). However, the Commissioner can agree to a later date for the election: s IC 9(2). The notification of the election may be made in the return, or by separate notice. Note that in the case of a subvention payment, the payment must also be made within the same time for notifying the Commissioner of the election: s IC 9(1).
22. In considering an application to apply this discretion, the Commissioner will be mindful of the purpose of the loss offset regime which is to allow those companies that incur losses to utilise those losses even where different entities are involved. There should be similarity in the tax treatment of a group of companies, each carrying on separate enterprises, as compared with a single company that carries on the same enterprises in separate divisions. A case need not be exceptional for the discretion to be exercised favourably. The Commissioner will generally extend the timeframe required to make loss offset elections where a loss offset would be allowed. However, where the loss company has already taken a tax position that does not provide for a loss offset of a (current year) net loss, an amendment to that tax position will be required to apply any subsequent loss offset election. It is logical that the same rationale that relates to an amendment under s 113 of the Tax Administration Act 1994 (TAA) - where this involves a change to a (current year) net loss - should be applied to the discretion to extend the date for making an election. This means that where an amendment to an assessment under s 113 (TAA) would be denied, the Commissioner would not extend the timeframe for notifying a late loss offset election.
23. To summarise this aspect, the decision to exercise the discretion to notify the late loss offset election will be based on whether the loss offset will be allowed. If the loss offset will be allowed, then the discretion will be exercised. Where the loss company is seeking to amend a position already taken with regard to the loss offset, the discretion will only be exercised where the approval under s 113 (TAA) would be applied.
24. Where the late election relates to the loss company's available tax losses other than a current year net loss (losses brought forward), then the same rationale that applies to amendments under section 113 (TAA) will equally apply to deciding whether the late election will be allowed. This rationale is set out in *SPS 16/01 Requests to amend assessments*<sup>2</sup>.

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<sup>2</sup> This statement can be found at [www.ird.govt.nz](http://www.ird.govt.nz) (search keyword: SPS 16/01).

### **Example 3**

A request to extend the date for making a loss offset election is filed on 10 April after 31 March of the year following the year of loss offset. The reason given for requesting the extension is that although the loss company's income tax return had been prepared and filed sometime previously there were numerous profit companies in the group and the preparation of those returns had taken time. Consequently, the income tax returns for the profit companies had been filed late. At the time of filing its return, the loss company was unaware of the group company's profit outcome. The loss company made no loss offset election within the time for the loss company to file their income tax return. Section 113 (TAA) would be applied to allow a loss offset. The reason is that the loss company was not aware of the full facts and erred when it took its tax position (refer para [59] of SPS 16/01 – Requests to amend assessments).

### *Further elections*

25. Once a loss company has made an election, it cannot withdraw that election or change any part of that election. It is final and irrevocable: s IC 5(4). However, further elections can be made in some cases, for instance a loss company is not limited to a single election in respect of only one profit company. As already noted, it must be remembered that any further elections would be treated as a request to amend an assessment under s 113 (TAA).

### **Part-year losses**

26. It is possible to offset a part-year loss (s IP 4) provided the following requirements as set out in s IP 4(2) are met:
  - the tax loss component arises in the common span (as defined in s IP 2(1)), and
  - the amount of the tax loss component is no more than the net income that the profit company derives in the common span, and
  - continuity of ownership in the loss company under s IC 2(1) applies from the beginning to the end of the common span, and
  - the loss company and the profit company provide the Commissioner with adequate financial statements under s IP 6. These accounts should contain sufficient information to indicate the calculation of the amount of the company's net income for the relevant part of the corresponding income year. The Commissioner's view is that the financial statements are required to be prepared in accordance with the generally accepted accounting practice, adjusted for the purposes of income tax legislation, at the level required under the Financial Reporting Act 2013 and the Tax Administration (Financial Statements) Order 2014. This does not require the preparation of notes to the accounts and disclosure statements. The part-year accounts will of necessity be different from full year accounts due to different ratios, denominators etc, and
  - a valid loss offset election (s IP 7) within the timeframes required for elections under s IC 9.

- As stated above, loss offsets are limited to the profit company's profit for the year (s IC 8 refers).
27. Where a company has a break in shareholder continuity part way through a month and its accounting system balances and reports at the end of the month, subject to the taxpayer backing out significant transactions pre or post the change in continuity, the Commissioner will accept the use of the end-of-month balance sheet figures for determining provision balances. She will also accept pro-rata allocation of the month's income and expenditure to determine the pre and post continuity change in net income or loss.
28. In some cases it may be difficult to prepare part-year accounts to the level of detail set out above, particularly where there has been a significant lapse of time since the loss of shareholder continuity for the part-year. In such circumstances, taxpayers may discuss their individual positions with the Commissioner and depending on the facts a different approach may be agreed upon.

### **Amended assessments**

29. In some cases, the Commissioner may amend an assessment for a profit or loss company resulting in increased or reduced net income or losses respectively. As a consequence there may be a need for further elections for additional loss offsets. There are four situations that may be brought about by amended assessments. These are:
- the available loss is reduced below the amount originally elected to be offset;
  - the available loss is increased;
  - the profit company has additional net income that could be the subject of an offset; and
  - the profit company has reduced net income below the level of the amount of the loss offset.

### *Reduced loss*

30. Where the loss company's assessment is amended (having its loss reduced below the level in the loss offset election) and consequently is not entitled to offset the amount elected then the following action will be taken:
- (i) where there is only one profit company then the Commissioner will, usually after consultation with the company or its agent, simply amend the assessment for the profit company in accordance with section 113 (TAA). No further election is necessary as the assessment of the profit company will reflect the reduced loss available to be offset, and
  - (ii) where there is more than one profit company the loss company will need to notify the Commissioner as to how that reduced loss is to be allocated to the profit companies pursuant to IC 11(3). If the loss company does not make this subsequent election within 6 months of the loss company being notified that its tax loss is reduced or within such further time as the Commissioner may allow, the reduced loss is allocated proportionately to the original amount of the loss offset allocated to each profit company: s IC 11(4).
31. In the case where the reduction results in a subvention payment being treated as a

dividend in the hands of the loss company, the dividend may be reduced to the extent this portion of the subvention payment is repaid to the profit company within the same timeframe discussed in the preceding paragraph: s IC 11(5).

#### *Increased loss*

32. Where the loss company's assessment is amended and therefore has additional losses to offset, a further election can be made for those additional losses. The first election remains valid and cannot be revoked. The further election must meet all the criteria set out above for an election, for example it must be on time, state the additional amount to be offset, and name the profit company or companies. As discussed already, any amendment will be subject to the SPS 16/01.

#### *Increased profit*

33. Where a profit company's assessment is amended and consequently has additional net income that could be the subject of an offset, a further election can be made by the loss company in respect of the additional net income within the statutory time period (set out in s IC 9(2)). This election must meet all the criteria for loss offsets. The emphasis will be on the notification of a loss offset by the loss company. It will not focus on the profit company's change in net income.

#### *Reduced profit*

34. Where a profit company's assessment is amended and therefore has reduced net income (below the level of the loss offset), the deduction for the profit company remains valid up to the reduced amount of the net income. The "unused" tax loss will be added back to the loss balance carried forward by the loss company. A further election can be made for the additional losses to other profit companies within the group. Any further election must meet all the relevant criteria for loss offsets.

### **Requests to amend assessments**

35. Changes to the assessments of the loss company or profit company may impact on the loss offset election already made and the availability of further loss offset elections. Examples are discussed in the immediately preceding paragraphs.
36. Requests will be looked at from the amending loss company's point of view. This means, for example, that the Commissioner will be considering why a loss company made an error with their initial loss offset. In that case, it may not be relevant why the profit companies' net income was amended.
37. Where there are any consequential impacts on the loss offset election and a further election needs to be made or the election needs to be revised, the taxpayer companies may need to consider whether s 113 (TAA) allows those changes to be implemented. SPS 16/01 sets out the circumstances when the Commissioner may amend assessments to ensure correctness, is relevant in considering whether the election should be accepted.
38. It should be noted that taking tax positions that both include or exclude a loss offset are each correct tax positions. The Commissioner will not amend one correct tax position to another correct tax position unless the initial tax position was made in error. The onus will be on the taxpayer to show that this was the case.
39. It is the Commissioner's practice that having approved a further election so that the

loss company's loss or the profit company's net income is increased or reduced, those amendments will be made. Generally, the Commissioner will not agree to amend an assessment where the taxpayer has previously had the opportunity to offset known losses, and has failed, for whatever reason, to do so.

This Standard Practice Statement is signed on 12 February 2020.

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