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TAX INFORMATION Bulletin

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Inland Revenue
Te Tari Taake

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YOUR OPPORTUNITY TO COMMENT

Inland Revenue regularly produces a number of statements and rulings aimed at explaining how taxation law affects taxpayers and their agents. Because we are keen to produce items that accurately and fairly reflect taxation legislation and are useful in practical situations, your input into the process, as a user of that legislation, is highly valued.

You can find a list of the items we are currently inviting submissions on as well as a list of expired items at **taxtechnical.ird.govt.nz** (search keywords: public consultation).

Email your submissions to us at **public.consultation@ird.govt.nz** or post them to:

Public Consultation
Tax Counsel Office
Inland Revenue PO Box 2198 Wellington 6140

You can also subscribe at **ird.govt.nz/subscription-service/subscription-form** to receive regular email updates when we publish new draft items for comment.

Your opportunity to comment

Ref	Draft type	Title	Comment deadline
PUB00428	Public rulings	GST – Supplies of properties used for transitional housing	31 Jan 2023

IN SUMMARY

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IN SUMMARY (continued)

Technical decision summaries

NEW LEGISLATION

This section of the *TIB* covers new legislation, changes to legislation including general and remedial amendments, and Orders in Council.

Order in Council – Income Tax (Tax Credit) Order 2022

Section MF 7 of the Income Tax Act 2007

Order

The Income Tax (Tax Credit) Order 2022, made on 14 November 2022, increases three Working for Families tax credits, to take effect from 1 April 2023.

Key features

Three Working for Families Tax Credits have been increased under section MF 7 of the Income Tax Act 2007. The tax credit amounts per year before and after are provided in the table below.

Tax Credit	Current amount	New amount
Family Tax Credit		
Eldest child	$6,642	$7,121
Subsequent child	$5,412	$5,802
Best Start Tax Credit	$3,388	$3,632
Minimum Family Tax Credit	$32,864	$34,216

The Family Tax Credit (FTC) amounts for the first and subsequent child in sections MD 3(4)(a) and (b) have been increased for inflation in accordance with section MF 7(1)(a) of the Income Tax Act 2007. The Best Start Tax Credit (BSTC) amount has also been adjusted for inflation under section MF 7(1)(a).

The intent of Cabinet policy for the Minimum Family Tax Credit (MFTC) is that low income working families remain better off financially in full time work than on a main benefit especially sole parents. As benefit rates are expected to increase from 1 April 2023, the MFTC will also need to be increased to achieve this policy intention.

Effective date

The new prescribed tax credit amounts will apply for the 2023–24 and later tax years.

View the Order in Council: **https://www.legislation.govt.nz/regulation/public/2022/0296/latest/LMS782495.html**

LEGISLATION AND DETERMINATIONS

This section of the *TIB* covers items such as recent tax legislation and depreciation determinations, livestock values and changes in FBT and GST interest rates.

COV 22/20: Variation to section 68CB(2) of the Tax Administration Act 1994

Variation

The Commissioner of Inland Revenue has, under the discretion provided under section 6I of the Tax Administration Act 1994, made the following statutory variation:

> For a general approval application in relation to the R&D tax credit for the 2021-2022 income tax year under section 68CB(2) of the Tax Administration Act 1994, for applicants whose 2021-2022 income year ends on 30 September 2022, the date on or before which that application must be filed with the Commissioner is amended to be 7 February 2023.
>
> This variation applies only where the impacts of COVID-19 have resulted in the applicant not receiving, prior to 1 August 2022, information from Inland Revenue or Callaghan Innovation that is reasonably necessary to efficiently make their application.

Application date

This variation applies from 3 November 2022 to 7 February 2023.

Dated at Wellington on 3 November 2022.

Jonathan Rodgers
Group Leader – Tax Counsel Office
Inland Revenue

Background (material under this heading does not form part of the variation)

Summary of effect

1. The effect of the variation will be to extend from 7 November 2022 to 7 February 2023 the time by which a person with a 30 September balance date, to be entitled to research and development tax credits under s LY 1 of the Income Tax Act 2007, must apply for a general approval for the 2021-2022 income year. This is only where COVID-19 has prevented applicants receiving in a timely manner information needed for their general approval applications.

Provisions affected

2. Section 68CB(2) of the Tax Administration Act 1994.

Application of variation

3. This variation applies to a person who is seeking the Commissioner's approval of their research and development activities by filing a general approval application for the 2021-2022 income year under s 68CB of the Tax Administration Act 1994.
4. The variation recognises that the impact of COVID-19 means that in some cases Inland Revenue and Callaghan Innovation have not been able to provide applicants with information and feedback they reasonably need to put together an adequate application in an efficient manner.
5. Customers can choose not to apply the variation to their circumstances. You can make that decision by taking a tax position, such as in a tax return, or by telling us. If you've already complied with the existing legislation in taking a tax position, we will consider that you have not chosen to apply the variation.

References

Legislative references

Tax Administration Act 1994: ss 6H and 6I, s 68CB(2)

DEP109: Tax Depreciation Rates for automated ship mooring systems

This determination sets depreciation rates for automated ship mooring systems used in the ordinary course of business.

Note to Determination DEP109:

The Commissioner has been asked to consider what depreciation rate should apply for automated ship mooring systems which are used for mooring ships at wharves and port facilities.

Automated mooring systems (or AMS) replace traditional mooring lines with an automatic moveable high strength steel arm connected to the wharf with a vacuum pad on the end of it. The pad clamps (or literally sucks itself onto) to the side of the vessel and the arm restrains and dampens the movement of the vessel against the wharf by means of hydraulics. Other AMS designs use electro-magnetic attraction rather than vacuum to fasten the pad to the ship hull.

For large vessels, multiple units are employed at each wharf. AMS units are either mounted on top of the wharf or, where areas have large tides that would exceed the vertical movement of the units between high and low tides, the AMS can be "face-mounted" on a ladder-like structure attached to the face of the wharf so that they can be moved vertically in step with the tide.

This determination introduces a generic asset class description to cover both the vacuum and electro-magnetic designs for AMS technology.

Determination DEP109: Tax Depreciation Rates General Determination Number 109

This determination may be cited as "Determination DEP109 Tax Depreciation Rates General Determination Number DEP109: Automated ship mooring systems" available for use in the ordinary course of business.

Application

This determination applies to taxpayers who own items of depreciable property of the kind listed in the tables below:

This determination will apply 1 April 2021, with application to the 2022 and subsequent income years.

Determination

Pursuant to section 91AAF of the Tax Administration Act 1994, the general determination will apply to the kind of items of depreciable property listed in the table below by:

- Adding into the "Transport" asset category, the new asset class, estimated useful life, and general diminishing value and straight-line depreciation rates listed below:

Asset class	Estimated useful life (years)	DV rate (%)	SL rate (%)
Automated ship mooring systems (vacuum, magnetic, hydraulic or winch type)	10	20	13.5

Interpretation

In this determination, unless the context otherwise requires, words and terms have the same meaning as in the Income Tax Act 2007 and the Tax Administration Act 1994.

Dated at Wellington on 19th October 2022.

Rob Falk
Technical Lead
Technical Standards, Legal Services

FDR 2022/02: A type of attributing interest in a foreign investment fund for which a person may not use the fair dividend rate method (iShares Green Bond Index Fund – NZD Share Class)

Any investment by a New Zealand resident investor in shares in the iShares Green Bond Index Fund – NZD Share Class to which none of the exemptions in sections EX 29 to 43 of the Income Tax Act 2007 apply, is a type of attributing interest for which the investor may not use the fair dividend rate ("FDR") method to calculate foreign investment fund income for the interest.

Reference

This determination is made under section 91AAO(1)(b) of the Tax Administration Act 1994. This power has been delegated by the Commissioner of Inland Revenue to the position of Technical Specialist – Network under section 7 of the Tax Administration Act 1994.

Discussion (which does not form part of the determination)

Shares in the New Zealand Dollar (NZD) denominated class of the iShares Green Bond Index Fund ("the Fund") as part of the BlackRock Fixed Income Dublin Funds public limited company ("BRFI") incorporated under the laws of Ireland to which this determination applies are an attributing interest in a foreign investment fund ("FIF") for New Zealand resident investors. BRFI is structured as an umbrella fund with segregated liability between sub-funds. These sub-funds do not have a separate legal personality.

New Zealand resident investors are required to apply the FIF rules to determine their tax liability in respect of their investment in shares in the NZD denominated class of the Fund ("the NZD Share Class") each year.

The Fund is a sub-fund of BRFI which invests in a portfolio of global fixed interest securities and other financial arrangements the proceeds of which are used to fund projects with direct environmental benefits.

The Fund has on issue a number of share classes that provide holders of that class with an interest in a pool of financial instruments held by the Fund. The NZD Share Class is a share class denominated in NZD. Foreign currency hedging arrangements are to be put in place which effectively provide investors with a New Zealand dollar denominated return on the financial arrangements held by the Fund.

Section EX 46(10)(c) of the Income Tax Act 2007 would not apply to prevent the use of the FDR method for interests in the NZD Share class but would apply if the Fund represented a separate foreign company and the NZD Share Class was the only class of share on issue.

The policy intention is that the FDR method of calculating FIF income should not be applied to investments that provide a New Zealand resident investor with a return similar to a New Zealand dollar denominated debt investment. It is appropriate for the Commissioner to take into account the whole of the arrangement including any interposed entities or financial arrangements in ascertaining whether an investment in a FIF provides the New Zealand resident investor with a return akin to a New Zealand dollar denominated debt investment.

On that basis, where a New Zealand resident invests in the NZD Share Class of the Fund, I consider that it is appropriate for them to be excluded from using the FDR method.

Scope of determination

This determination is issued on the basis of information provided to the Commissioner before the date of this determination and applies to an attributing interest in a FIF held by New Zealand resident investors in a non-resident issuer where:

- This non-resident issuer:
  - is incorporated in Ireland and issues multiple classes of shares; and
  - is known at the date of this determination as BlackRock Fixed Income Dublin Funds public limited company; and
  - is structured as an umbrella fund with segregated liability between sub-funds.

- The attributing interest consists of the New Zealand dollar denominated class of share, issued in the iShares Green Bond Index Fund, a sub-fund of BlackRock Fixed Income Dublin Funds public limited company, that provides exposure solely to a portfolio predominantly of fixed interest securities and other financial arrangements
- The investment assets attributable to the New Zealand dollar denominated class of share are subject to foreign currency hedging arrangements undertaken by the non- resident for the purpose of eliminating to the extent possible any exchange rate risk for New Zealand investors on a highly effective basis.

Interpretation

In this determination, unless the context otherwise requires-

"Fair dividend rate method" means the fair dividend rate method under section YA 1 of the Income Tax Act 2007;

"Financial arrangement" means financial arrangement under section EW 3 of the Income Tax Act 2007;

"Foreign investment fund" means foreign investment fund under section YA 1 of the Income Tax Act 2007;

"Non-resident" means a person that is not resident in New Zealand for the purposes of the Income Tax Act 2007;

"The Fund" means the iShares Green Bond Index Fund, a sub-fund of BlackRock Fixed Income Dublin Funds public limited company.

Determination

An attributing interest in a FIF to which this determination applies is a type of attributing interest for which a person may not use the FDR method to calculate FIF income from the interest.

Application Date

This determination applies for the 2022-2023 income year and subsequent income years.

However, under section 91AAO(3B) of the Tax Administration Act 1994, this determination does not apply for a person and an income year beginning before the date of the determination unless the person chooses that the determination applies for the income year.

Dated on this 14th day of October 2022.

Iain McConville
Technical Specialist

BINDING RULINGS

This section of the *TIB* contains binding rulings that the Commissioner of Inland Revenue has issued recently. The Commissioner can issue binding rulings in certain situations. Inland Revenue is bound to follow such a ruling if a taxpayer to whom the ruling applies calculates their tax liability based on it.

For full details of how binding rulings work, see *Binding rulings: How to get certainty on the tax position of your transaction (IR715)*. You can download this publication free from our website at **www.ird.govt.nz**

BR Prd 22/11: Australia and New Zealand Banking Group Limited (ANZBGL)

This is a product ruling made under s 91F of the Tax Administration Act 1994.

Name of person who applied for the Ruling

This Ruling has been applied for by Australia and New Zealand Banking Group Limited (ANZBGL).

Taxation Laws

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

This Ruling applies in respect of s CX 55 and Part C of the Act.

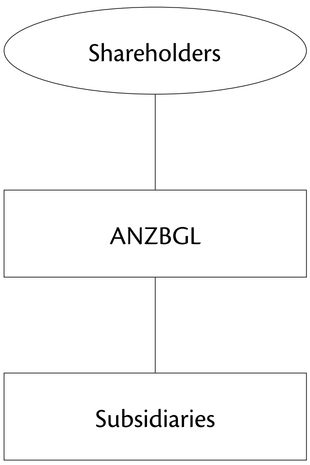
The Arrangement to which this Ruling applies

The Arrangement is that ANZBGL shareholders will exchange their ANZBGL ordinary shares for shares in a non-operating holding company (NewANZ), as part of a reorganisation of ANZBGL and its subsidiaries (NOHC Reorganisation).

Further details of the Arrangement are set out in the paragraphs below.

ANZBGL

1. ANZBGL is:
   (a) tax resident only in Australia; and
   (b) required to maintain a franking account for Australian income tax purposes.
2. ANZBGL's ordinary shares are:
   (a) on the official list of ASX Limited; and
   (b) not "fixed-rate shares" as defined in s YA 1, as the dividends payable on the ordinary shares are not restricted to dividends payable at a rate that is a specific percentage or is determined by reference to an external index or rate.
3. The following diagram summarises the current structure of ANZBGL and its subsidiaries (ANZ Group).



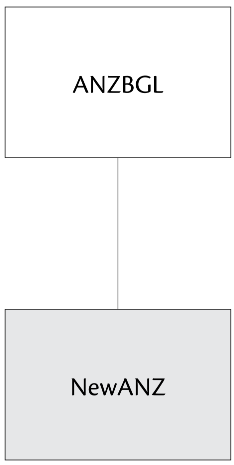
BINDING RULINGS

Persons to who the Ruling applies

4. The Ruling applies to ANZBGL shareholders who are issued NewANZ shares under the Arrangement, where those shareholders:
   (a) are not subject to the following sections of the Act in relation to the Arrangement (referred to in this Ruling as ANZBGL Capital Shareholders):
      i) s CB 1, because they do not derive the shares from a business or, if they do derive the shares from a business, they receive them on capital account;
      ii) s CB 2, because they do not hold their ANZBGL shares as trading stock;
      iii) s CB 4, because they did not acquire their ANZBGL shares for the purpose of disposal;
      iv) s CB 5, because they are not in the business of dealing in shares;
      v) s CV 1, because they are not a company that for that income year is part of a wholly-owned group of companies and had the group of companies been a single company, the shares derived by the company would have been income of that single company under s CB 1, CB 2, CB 4 or CB 5; and
      vi) s CV 2 in relation to the Arrangement because they are not a company that is part of a consolidated group, when the shares derived by the company would be income of the group if the group were one company under s CB 1, CB 2, CB 4 or CB 5; and
   (b) are not ANZBGL Capital Shareholders, but instead they (referred to in this Ruling as ANZBGL PIE Shareholders):
      i) are a "portfolio investment entity" other than a "life fund PIE" as defined in s YA 1; and
      ii) are not assured, under an arrangement with another person, of having a gain on the disposal.
5. For the avoidance of doubt, this Ruling does not apply to ANZBGL group employees:
   (a) who are participants in any of the ANZBGL employee share schemes; and
   (b) where their shares in the relevant employee share scheme are not held on bare trust.

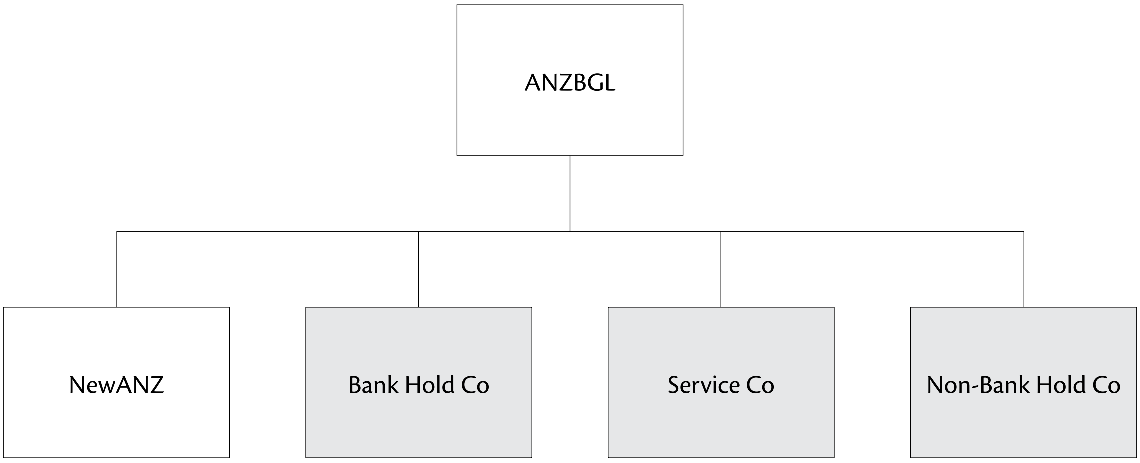
NOHC Reorganisation

6. The NOHC Reorganisation consists of seven steps as the following diagrams summarise:
   (a) Step 1: NewANZ, a non-operating holding company, is incorporated as a wholly- owned subsidiary of ANZBGL with nominal share capital.

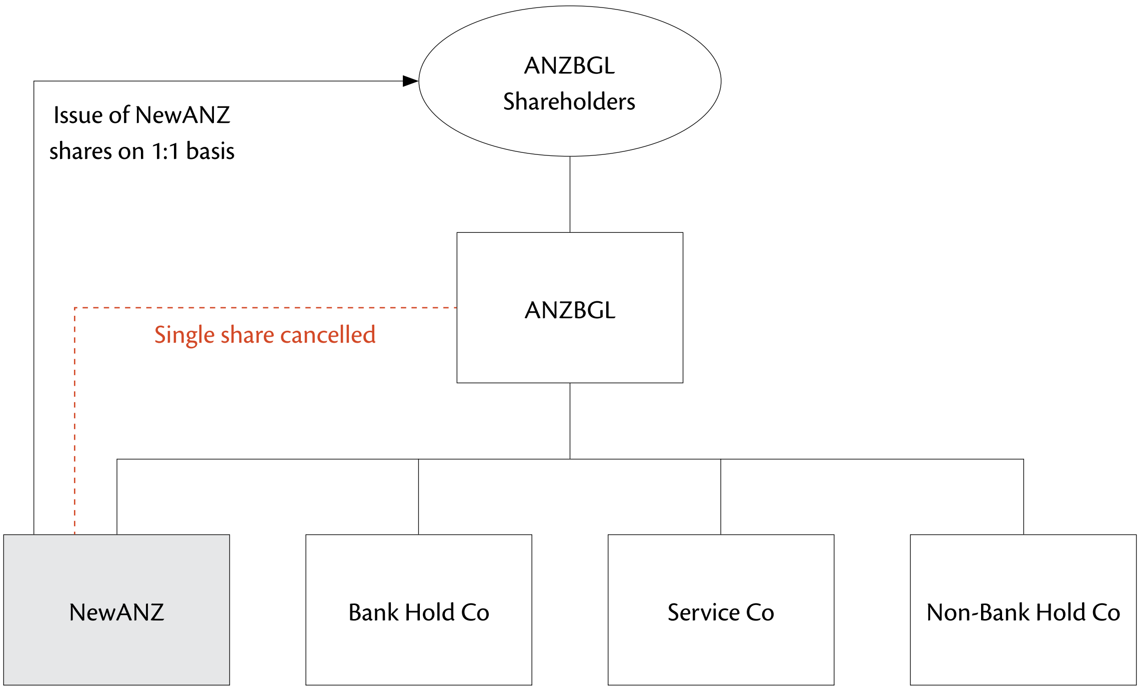


BINDING RULINGS

(b) Step 2: ANZBGL incorporates (with nominal share capital) three wholly-owned subsidiaries: Bank Hold Co (prospective holding company for ANZBGL), Non-Bank Hold Co and Service Co.



(c) Step 3: NewANZ issues shares (on a one-for-one basis) to eligible ANZBGL shareholders in exchange for the transfer described in step 4 under a court-approved scheme of arrangement.



(d) Ineligible foreign shareholders will not participate in steps 3 and 4 as described here. Instead:

i) their ANZBGL shares will be transferred to a foreign sale facility agent immediately before step 4;

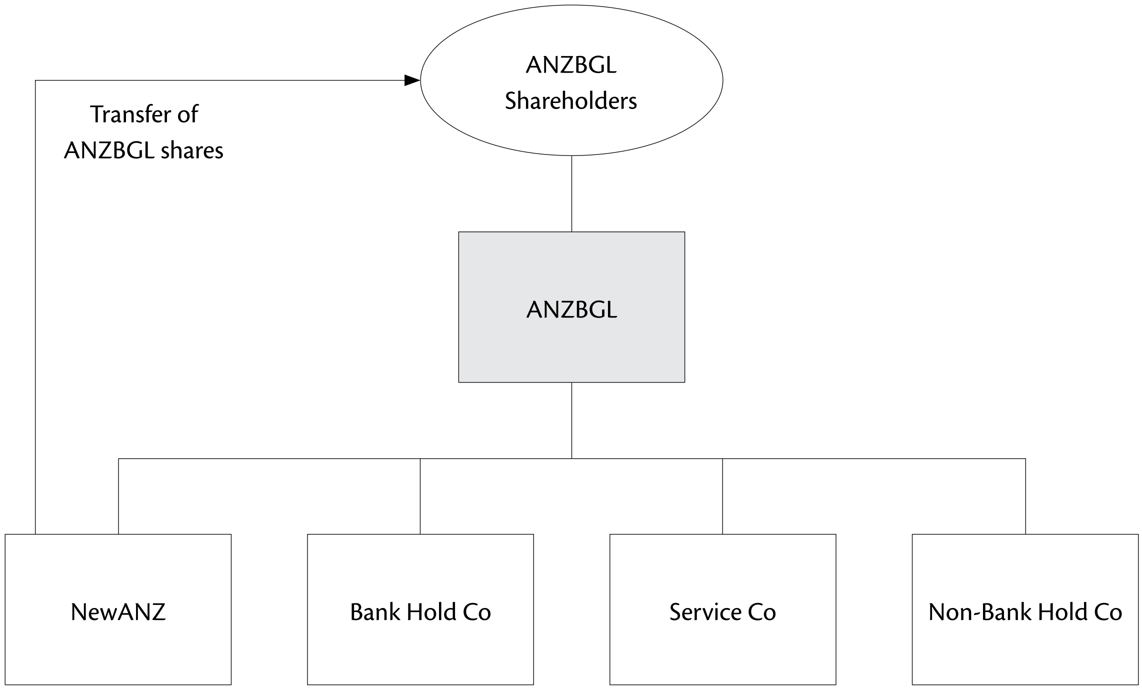
ii) the facility will be issued with NewANZ shares (on a one-for-one basis) as part of step 3;

iii) the facility will transfer the ANZBGL shares to NewANZ as part of step 4; and

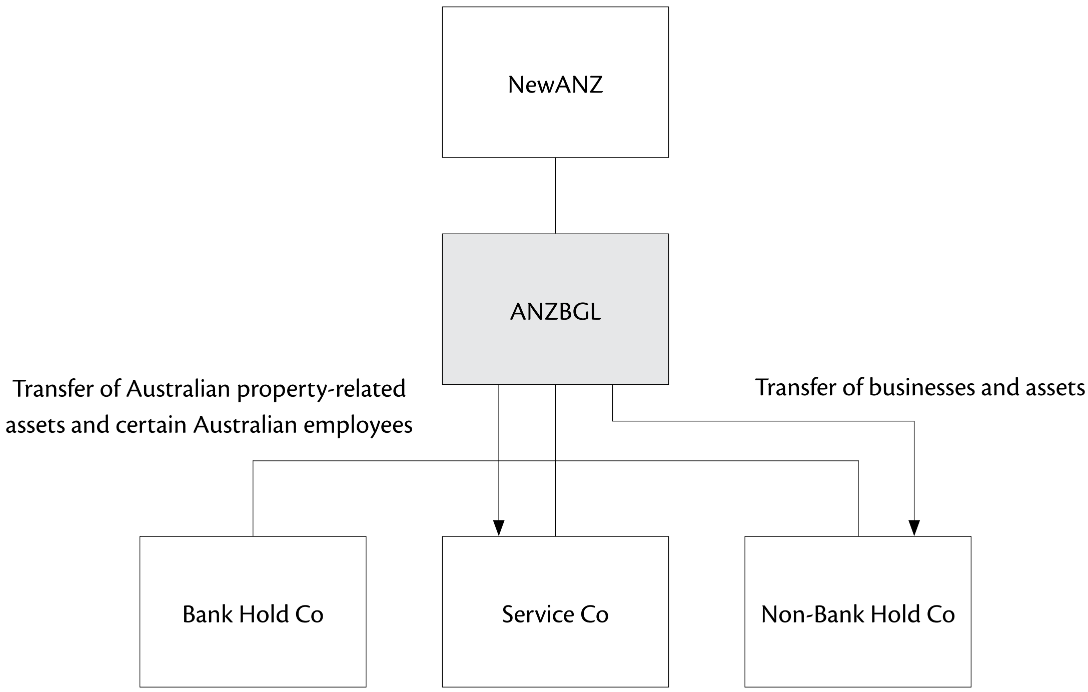
iv) the facility will sell the NewANZ shares and remit the net proceeds to ineligible foreign shareholders.

(e) At the same time as NewANZ issues the shares, NewANZ buys back and cancels the original nominal share capital held by ANZBGL (the single share depicted in the diagram above).

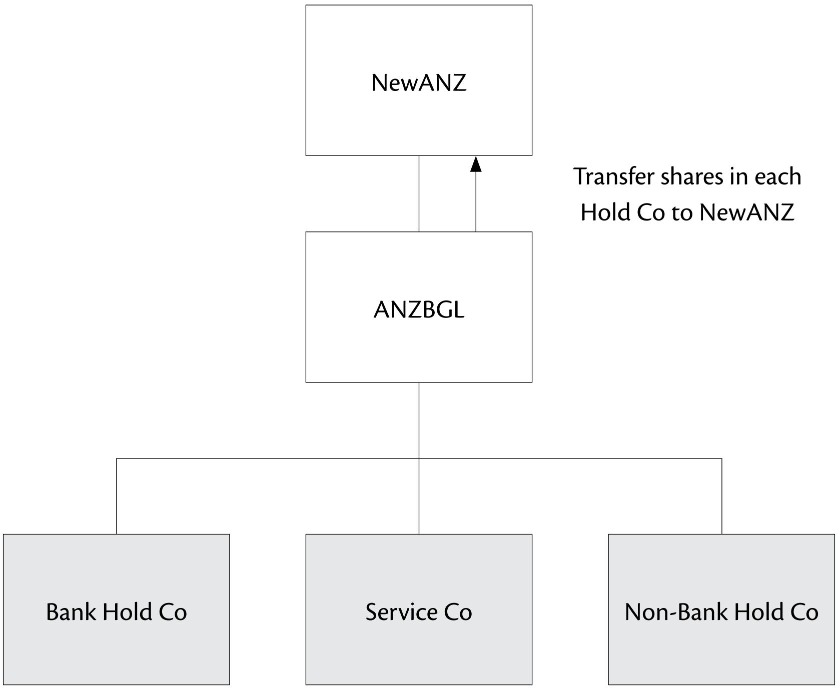
(f) Step 4: On the same day, and in consideration for the share issue in step 3, ANZBGL shareholders transfer their ordinary shares in ANZBGL to NewANZ. The value of the NewANZ shares will be equal to the value of the ANZBGL shares, as they will carry the same rights.



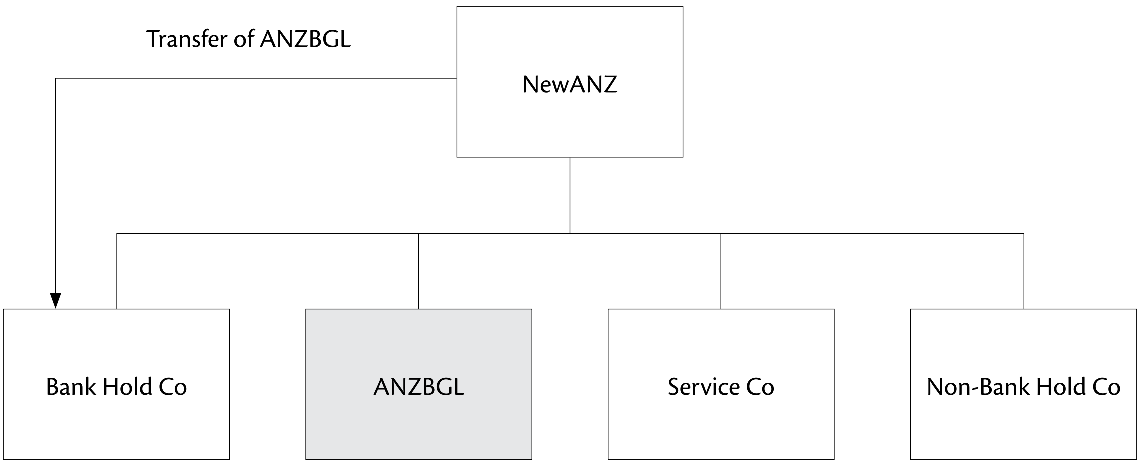
(g) Step 5: ANZBGL transfers non-banking businesses and assets to Non-Bank Hold Co, and relevant assets and employees to Service Co.



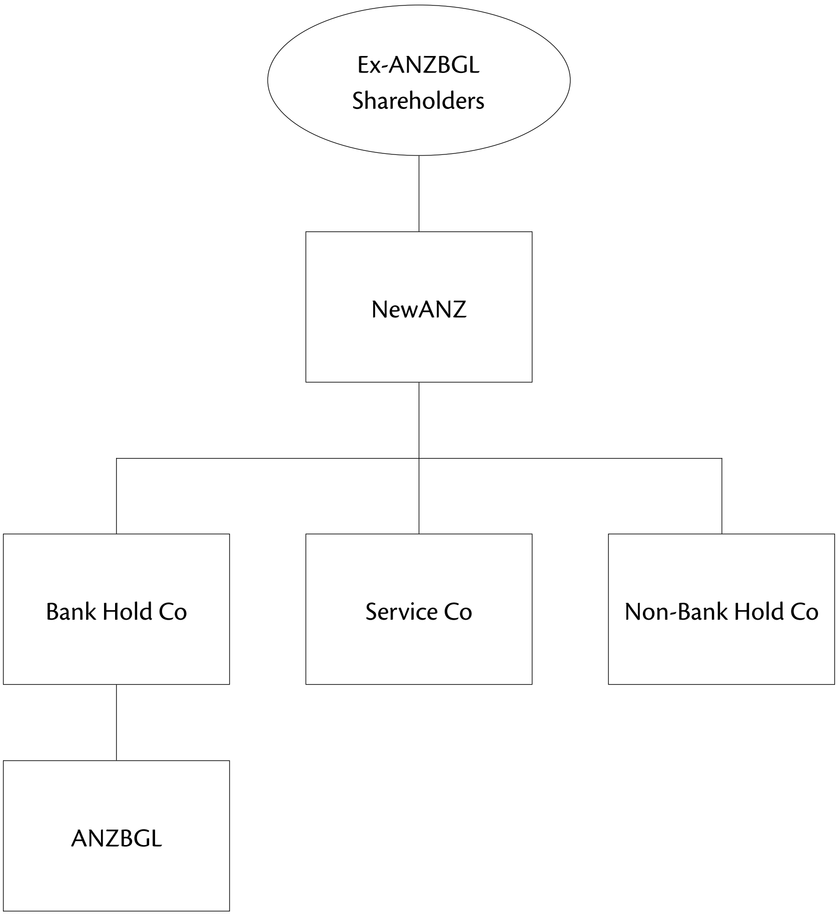
(h) Step 6: ANZBGL transfers its shares in Bank Hold Co, Non-Bank Hold Co and Service Co to NewANZ.



(i) Step 7: NewANZ transfers shares in ANZBGL to Bank Hold Co.



7. The following diagram summarises the post-reorganisation position.



How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

(a) The receipt of NewANZ shares by ANZBGL Capital Shareholders under the Arrangement will not be income under Part C.

(b) The receipt of NewANZ shares by ANZBGL PIE Shareholders under the Arrangement will be excluded income under s CX 55.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 1 October 2022 and ending on 30 September 2024.

This Ruling is signed by me on the 17th day of October 2022.

Howard Davis
Group Leader, Tax Counsel Office

BR Prd 22/12: ANZ Bank New Zealand Limited (ANZ)

This is a product ruling made under s 91F of the Tax Administration Act 1994.

Name of person who applied for the Ruling

This Ruling has been applied for by ANZ Bank New Zealand Limited (ANZ).

Taxation Laws

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

This Ruling applies in respect of ss CE 1(1)(d) and CW 26B.

The Arrangement to which this Ruling applies

The Arrangement is that Australia and New Zealand Banking Group Limited (ANZBGL) shareholders will exchange their ANZBGL ordinary shares for shares in a non-operating holding company (NewANZ), as part of a reorganisation of ANZBGL and its subsidiaries (NOHC Reorganisation), and the related amendments to the ANZBGL employee share schemes.

Further details of the Arrangement are set out in the paragraphs below.

Persons to who the Ruling applies

1. This Ruling applies to New Zealand tax resident employees (Employees) of ANZBGL and its subsidiaries (ANZ Group) as at the date of the NOHC Reorganisation who are participants in an employee share scheme of the ANZ Group (being the Exempt Share Scheme, the ESAP or the ESOP – as defined below at [4]).

Relevant documents

2. The following documents are relevant to the Arrangement:
   a) the employee share acquisition plan rules (as amended by a board resolution on 25 October 2010 and by human resources committee resolutions on 16 September 2010, 30 July 2013 and 31 May 2017, and applying to any shares granted under the plan on or after 31 May 2017) (ESAP Rules);
   b) the schedule: New Zealand specific rules – ANZ employee share acquisition plan (amended on 25 September 2013) (ESAP Schedule);
   c) a deed of trust made on 2 June 1998 (as amended on 29 September 2003, 16 December 2005 and 26 October 2011) between ANZBGL (Bank) and ANZEST Pty Limited (Trustee) (contained in a deed of amendment made on 26 October 2011, Schedule 1) (Trust Deed);
   d) the ANZ share option plan rules (as amended by board resolutions on 23 October 2002, 8 November 2007 and 26 October 2010 and by human resources committee resolutions on 16 September 2010, 22 October 2012 and 31 May 2017, and applying to any options granted on or after 31 May 2017) (ESOP Rules); and
   e) proposed amendments to ESAP Rules and ESOP Rules provided to Inland Revenue on 30 June 2022, and Trust Deed provided to Inland Revenue on 10 October 2022.

3. The final executed documentation will not be materially different from the draft documentation provided to Inland Revenue, as set out in para 2)e) above.

Current ANZ Group employee share schemes

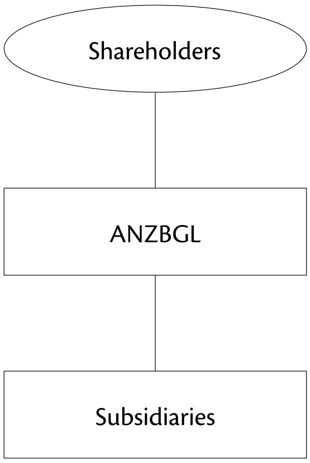
4. ANZBGL has entered into three employee share schemes through which employees of the ANZ Group are eligible to receive ANZBGL shares or options on such terms as the ANZBGL board decides are appropriate to the circumstances of the employee. The employee share schemes are:
   a) the Exempt Share Scheme (a general employee scheme offered to employees that received the Commissioner's approval under (now repealed) s DC 12 in respect of shares in ANZBGL (provided under the ESAP Rules, the ESAP Schedule and the Trust Deed);
   b) the ESAP (an incentive scheme offered to selected employees) in respect of shares in ANZBGL (provided under the ESAP Rules and the Trust Deed); and

c) the ESOP (a share option plan) in respect of options in ANZBGL shares through which selected employees of the ANZ Group are eligible to acquire ANZBGL options on such terms as the ANZBGL board decides are appropriate to the circumstances of the employee (provided under the ESOP Rules).

5. In respect of the ESAP and ESOP, ANZBGL advises no income has previously arisen to the Employees under s CE 1(1)(d).

ANZ Group

6. The following diagram summarises the current structure of the ANZ Group.



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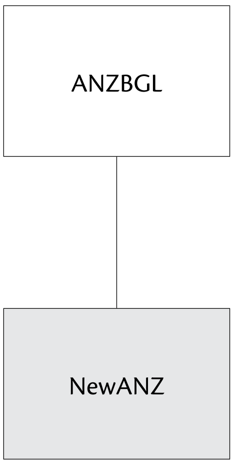
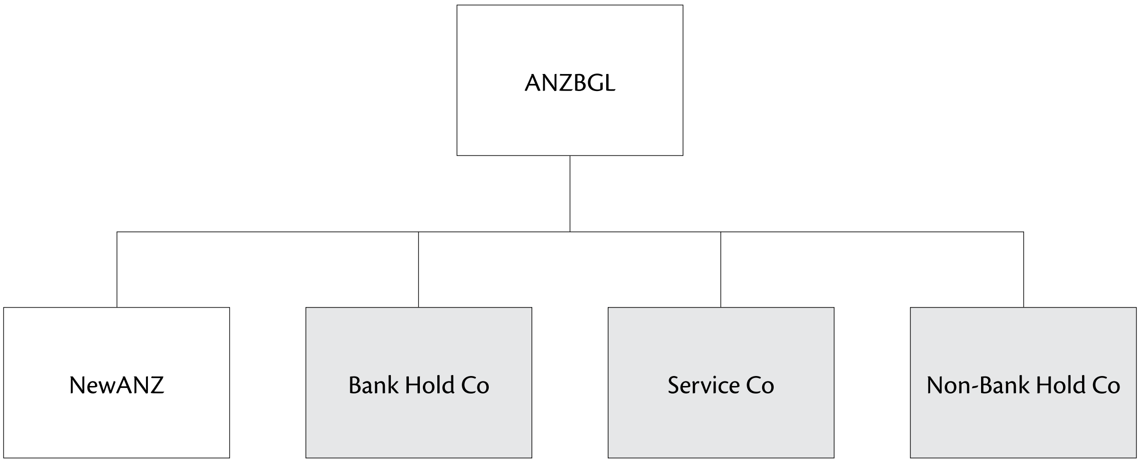
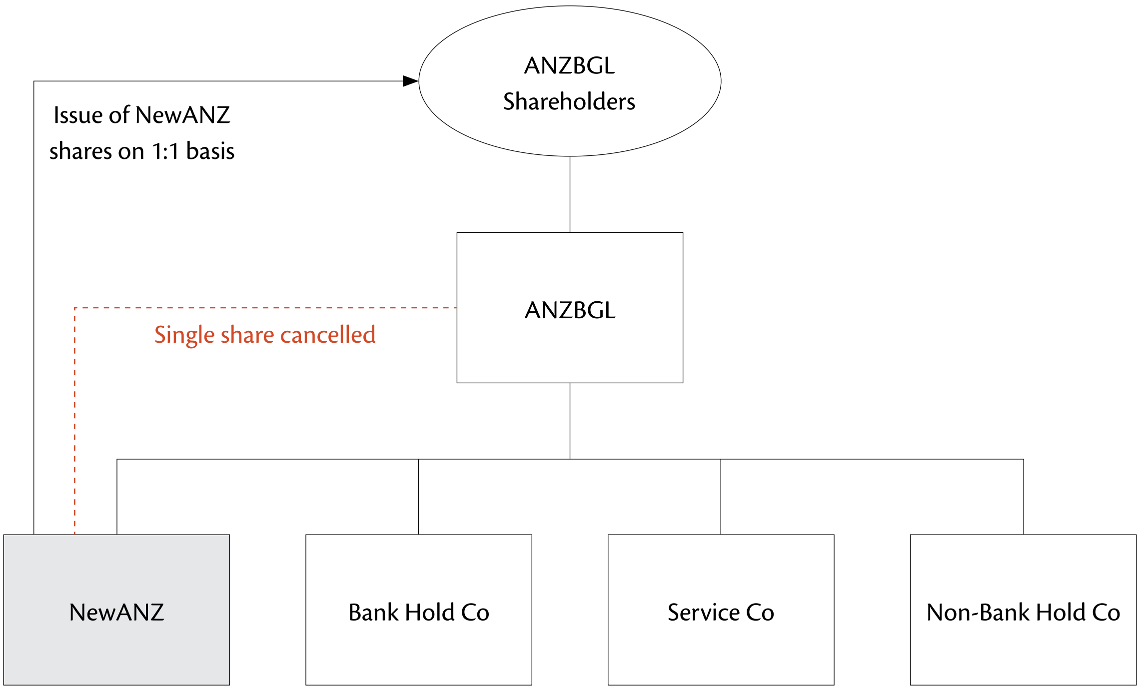


(b) Step 2: ANZBGL incorporates (with nominal share capital) three wholly-owned subsidiaries: Bank Hold Co (prospective holding company for ANZBGL), Non-Bank Hold Co and Service Co.



(c) Step 3: NewANZ issues shares (on a one-for-one basis) to eligible ANZBGL shareholders in exchange for the transfer described in step 4 under a court-approved scheme of arrangement (Scheme of Arrangement).



(d) Ineligible foreign shareholders will not participate in steps 3 and 4 as described here. Instead:

i) their ANZBGL shares will be transferred to a foreign sale facility agent immediately before step 4;

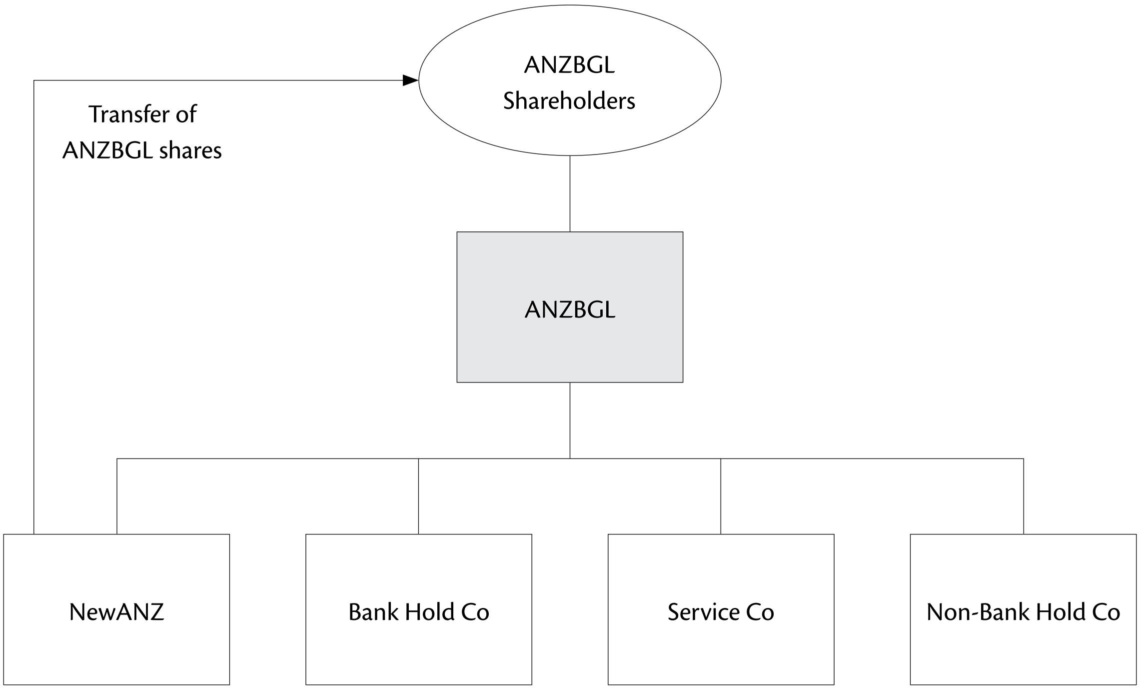
ii) the facility will be issued with NewANZ shares (on a one-for-one basis) as part of step 3;

iii) the facility will transfer the ANZBGL shares to NewANZ as part of step 4; and

iv) the facility will sell the NewANZ shares and remit the net proceeds to ineligible foreign shareholders.

(e) At the same time as NewANZ issues the shares, NewANZ buys back and cancels the original nominal share capital held by ANZBGL (the single share depicted in the diagram above).

(f) Step 4: On the same day, and in consideration for the share issue in step 3, ANZBGL shareholders transfer their ordinary shares in ANZBGL to NewANZ. The value of the NewANZ shares will be equal to the value of the ANZBGL shares, as they will carry the same rights.



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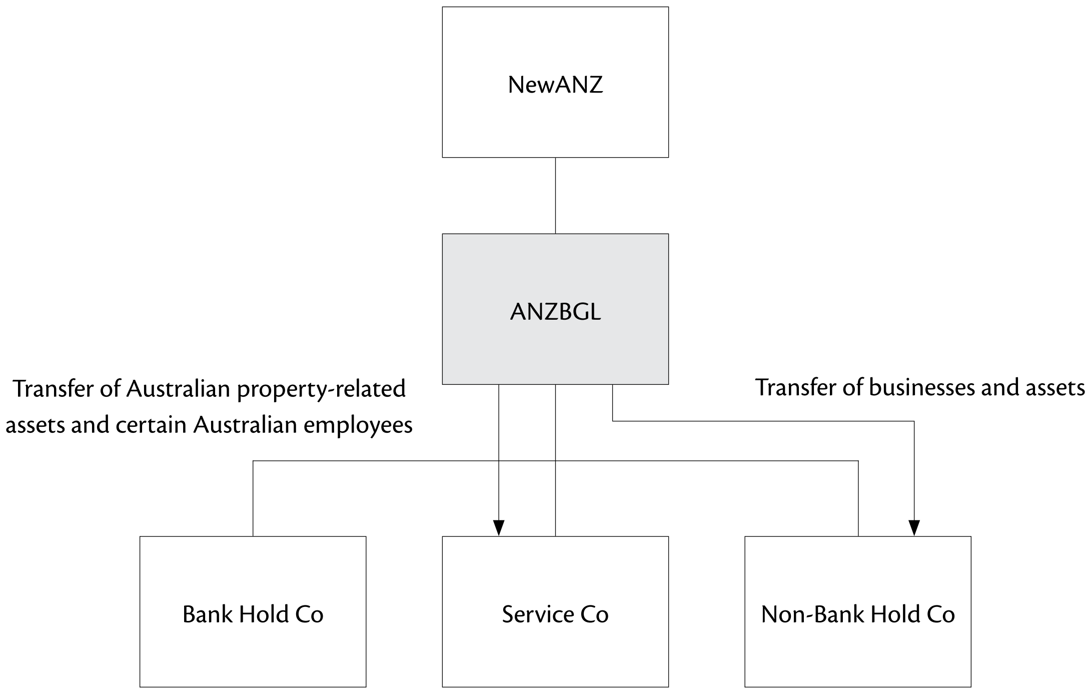

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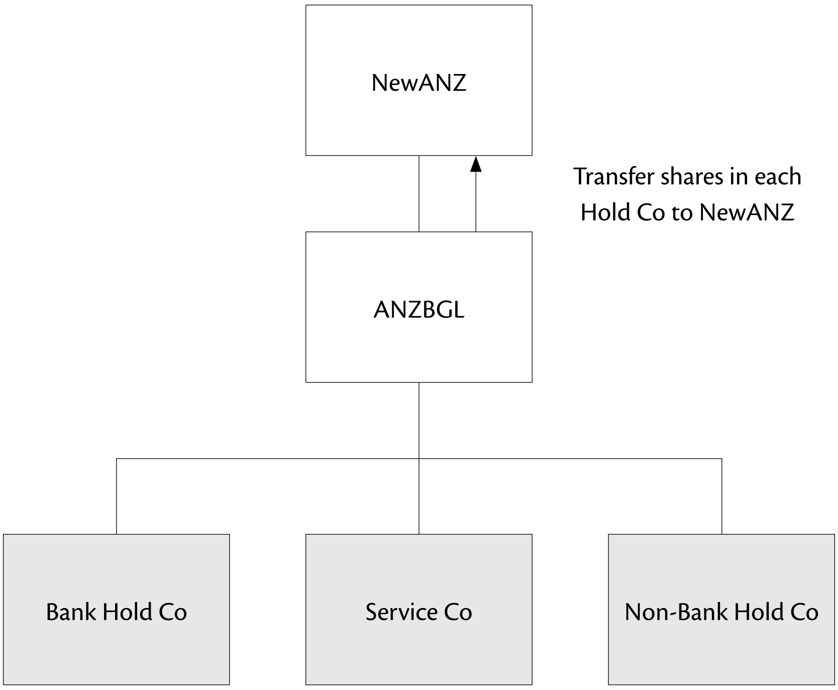
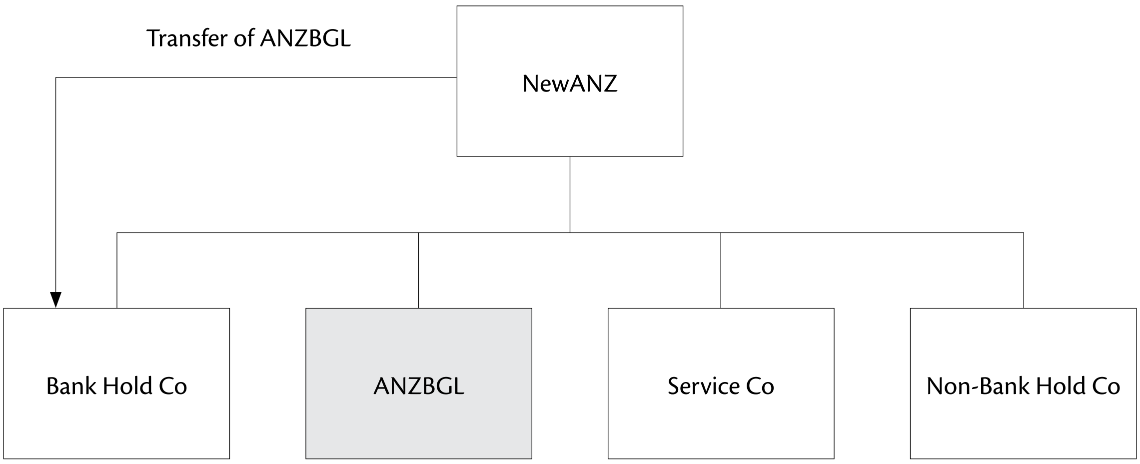
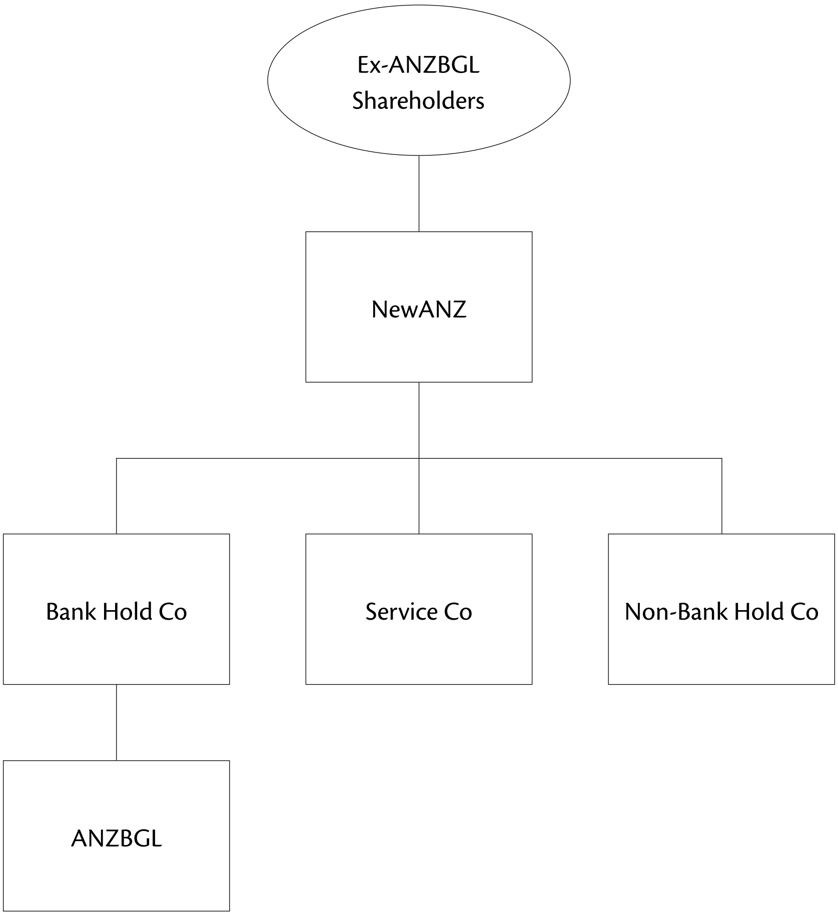


(i) Step 7: NewANZ transfers shares in ANZBGL to Bank Hold Co.



8. The following diagram summarises the post-reorganisation position.



Effect of NOHC Reorganisation on employee share schemes

9. Consistent with the Scheme of Arrangement, an Employee who holds a share or option or a right to receive a share or option in ANZBGL under or from the Exempt Share Scheme, ESAP or ESOP shall receive a share or option or right to receive a share or option in NewANZ under the Exempt Share Scheme, ESAP or ESOP on a one-for-one basis (as applicable) such that they continue to hold an equivalent interest in the parent company of the ANZ Group (NewANZ).

Exempt Share Scheme

10. In respect of the Exempt Share Scheme:

    (a) The shares were sold to the Employees for 1 cent each (but held by the Trustee until the end of the period of restriction). ANZBGL made no loans to Employees to subscribe for the shares.

    (b) The period of restriction (preventing the Employees from dealing in the shares allocated to them) in relation to the last allocation of shares to occur under the Exempt Share Scheme ceases to apply on 2 December 2022 (Final Vesting Date).

    (c) On or after the Final Vesting Date:

        i) the Employees have full beneficial ownership of the shares;

        ii) the Trustee holds the shares as a bare trustee for the Employees;

        iii) Employees have the option under clause 6.1 of the ESAP Schedule to have the Trustee transfer or purchase the shares. If an Employee chooses neither option, the Trustee continues to hold the shares until the relevant Employee subsequently elects an option. Those rights Employees have in relation to such shares are subject to general trading restrictions (eg, securities law restrictions preventing insiders from selling shares during designated periods).

(d) Shares the Trustee legally transfers to an Employee under the Exempt Share Scheme before the Implementation Date will be subject to the Scheme of Arrangement. Shareholders will exchange their ANZBGL shares for NewANZ shares on a one-for-one basis.

(e) For shares the Trustee legally holds for Employees on the Implementation Date (pending an election to be made by an Employee), the ANZBGL board will exercise its discretion to treat those shares the Trustee holds in the same way as other ANZBGL shares in the NOHC Reorganisation. That is, the shares the Trustee holds will be subject to the Scheme of Arrangement, and the Trustee will exchange its ANZBGL shares with NewANZ shares on a one-for-one basis.

(f) Up to and at the time of the Final Vesting Date, the Exempt Share Scheme will meet the criteria under which it obtained the Commissioner's approval under the now repealed s DC 12.

ESAP

11. In respect of the ESAP:

(a) The ANZBGL board will exercise its discretion to treat any shares the Trustee holds in the same way as other ANZBGL shares in the NOHC Reorganisation. That is, the shares the Trustee holds will be subject to the Scheme of Arrangement, and the Trustee will exchange its ANZBGL shares with NewANZ shares on a one-for-one basis.

(b) The ESAP Rules will be amended to:

i) include an express provision on the treatment of restricted shares if an NOHC Reorganisation occurs; and

ii) expand the definition of 'ANZ' in the ESAP Rules to include NewANZ (with effect from the Implementation Date) to allow the shares provided to Employees under the ESAP to be shares in NewANZ.

(c) NewANZ will assume all material responsibilities for the management of the ESAP.

12. The proposed amendments to the ESAP Rules provided to Inland Revenue on 30 June 2022 include the following (amendments in red):

2.1 **Definitions**

In these Rules:

ANZ means Australia and New Zealand Banking Group Limited ABN 11 005 357 522 and, with effect from the Implementation Date, includes [ANZ NOHC]:

[ANZ NOHC] means **[Insert name and ACN]:**

Implementation Date means the implementation date under a scheme of arrangement whereby **[ANZ NOHC]** (a non-operating holding company) becomes the ultimate holding company of Australia and New Zealand Banking Group Limited ABN 11 005 357 522 (expected to be on or around 1 January 2023):

Share means a fully paid share in the capital of ANZ

12.4 **Acquiring Company**

If [ANZ NOHC] (Acquiring Company) obtains control of ANZ as a result of a scheme of arrangement between ANZ and its shareholders:

Shares acquired under the Plan will be affected in the same way as other Shares; and

~~(f)~~(b) ANZ and the Acquiring Company may agree that the resulting shares in the Acquiring Company will continue to be governed under the Plan and on the same terms as the Shares (as reasonably assessed by ANZ and **[ANZ NOHC]**).

ESOP

13. In respect of the ESOP:

(a) The options or rights to options will not be subject to the Scheme of Arrangement in the way described above.

(b) Instead, the ANZBGL board will exercise its discretion to amend the ESOP Rules to effectively replace ANZBGL options or rights to options with NewANZ options or rights to options, on the same terms and conditions ('a rollover'). Legally, the ANZBGL board will, under the (to be) amended ESOP Rules, cancel all existing options or rights to options in ANZBGL and grant new options or rights to options in NewANZ.

(c) The ESOP Rules will be amended to include:

i) NewANZ in the expanded definition of 'ANZ' (with effect from the Implementation Date); and

ii) a 'replacement grant' provision that allows NewANZ to issue new options or rights to options in NewANZ.

14. The proposed amendments to the ESOP Rules provided to Inland Revenue on 30 June 2022 include the following (amendments in red):

5.9 **Acquisition of shares in Acquiring Company**

If a company **(Acquiring Company)** obtains control of ANZ as a result of:

(a) a takeover bid;

(b) a scheme of arrangement between ANZ and its shareholders,

and both ANZ and the Acquiring Company agree, ANZ may:

(c) on the exercise of options, instead of providing Shares, provide shares of the Acquiring Company or its parent to the same value (as reasonably assessed by ANZ) as the Shares in ANZ that would have been issued; or

~~(c)~~(d) if the Acquiring Company is **[ANZ NOHC]**, replace the Options with options over shares in the Acquiring Company to the same value and on the same terms (as reasonably assessed by ANZ) as the Options, and such options will continue to be governed under the Plan.

Trust Deed

15. The Trust Deed, which is a document relevant to all three employee share schemes, will be subject to a range of amendments, including that the employee share schemes will operate in relation to NewANZ shares.

16. The proposed amendments to the Trust Deed provided to Inland Revenue on 10 October 2022 include the following amendments in red:

2 **ANZ Group Holdings Limited**

ACN 659 510 791

of 833 Collins Street, Melbourne

(ANZ)

…

~~D.~~E ANZ will become the ultimate holding company and a non-operating company of the Bank from the 'implementation date' under a scheme of arrangement (expected to be on or around 1 January 2023). ANZ will be a listed entity and all Bank shares will be exchanged for ANZ shares. Accordingly, with effect from the implementation date and conditional on implementation occurring, the Plans will operate in relation to ANZ shares and the definitions of **Bank, Board, Plans and Shares** in this deed of trust will include ANZ, the Board of ANZ, plans or share acquisition arrangements authorised by the Board of ANZ from time to time (including the ANZ Employee Share Option Plan and the ANZ Employee Share Acquisition Plan), and shares in ANZ (respectively).

…

13 General

(a) Upon and with effect on and from the implementation date of the scheme referred to in recital (E) to this deed, and conditional on implementation of the scheme of arrangement occurring:

(1) the Plans will operate in relation to ANZ shares instead of shares in the Bank; and

(2) each reference in this deed of trust to the Bank, Board, Plans and Shares will be taken instead to include be a reference to ANZ, the Board of ANZ, plans or employee share schemes of ANZ from time to time (including the ANZ Employee Share Option Plan and the ANZ Employee Share Acquisition Plan) and shares in ANZ (respectively).

BINDING RULINGS

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

a) The Arrangement will not prevent income arising to Employees under the Exempt Share Scheme from being exempt income under s CW 26B.

b) The Arrangement will not give rise to income under s CE 1(1)(d) to the Employees who hold shares or rights to shares under the ESAP.

c) The Arrangement will not give rise to income under s CE 1(1)(d) to the Employees who hold options or rights to options under the ESOP.

The period or income year for which this Ruling applies

This Ruling will apply for the period beginning on 1 October 2022 and ending on 30 September 2024.

This Ruling is signed by me on the 17th day of October 2022.

Howard Davis
Group Leader, Tax Counsel Office

INTERPRETATION STATEMENTS

This section of the *TIB* contains interpretation statements issued by the Commissioner of Inland Revenue.

These statements set out the Commissioner's view on how the law applies to a particular set of circumstances when it is either not possible or not appropriate to issue a binding public ruling.

In most cases Inland Revenue will assess taxpayers in line with the following interpretation statements. However, our statutory duty is to make correct assessments, so we may not necessarily assess taxpayers on the basis of earlier advice if at the time of the assessment we consider that the earlier advice is not consistent with the law.

IS 22/06: Loss carry-forward – continuity of business activities

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.

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:
     - the last day of the income year in which the tax loss component in question is used; and
     - the last day of the income year in which the fifth anniversary of the ownership continuity breach falls.

     However, broadly, for a company where 50% or more of its tax losses eligible for carry-forward arose from bad debt deductions, the business continuity period will end on the last day of the income year in which the tax loss component in question is used. In other words, the five-year cap on the test will not apply (s IB 4).
   - 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**

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> **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).
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.

[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].

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.

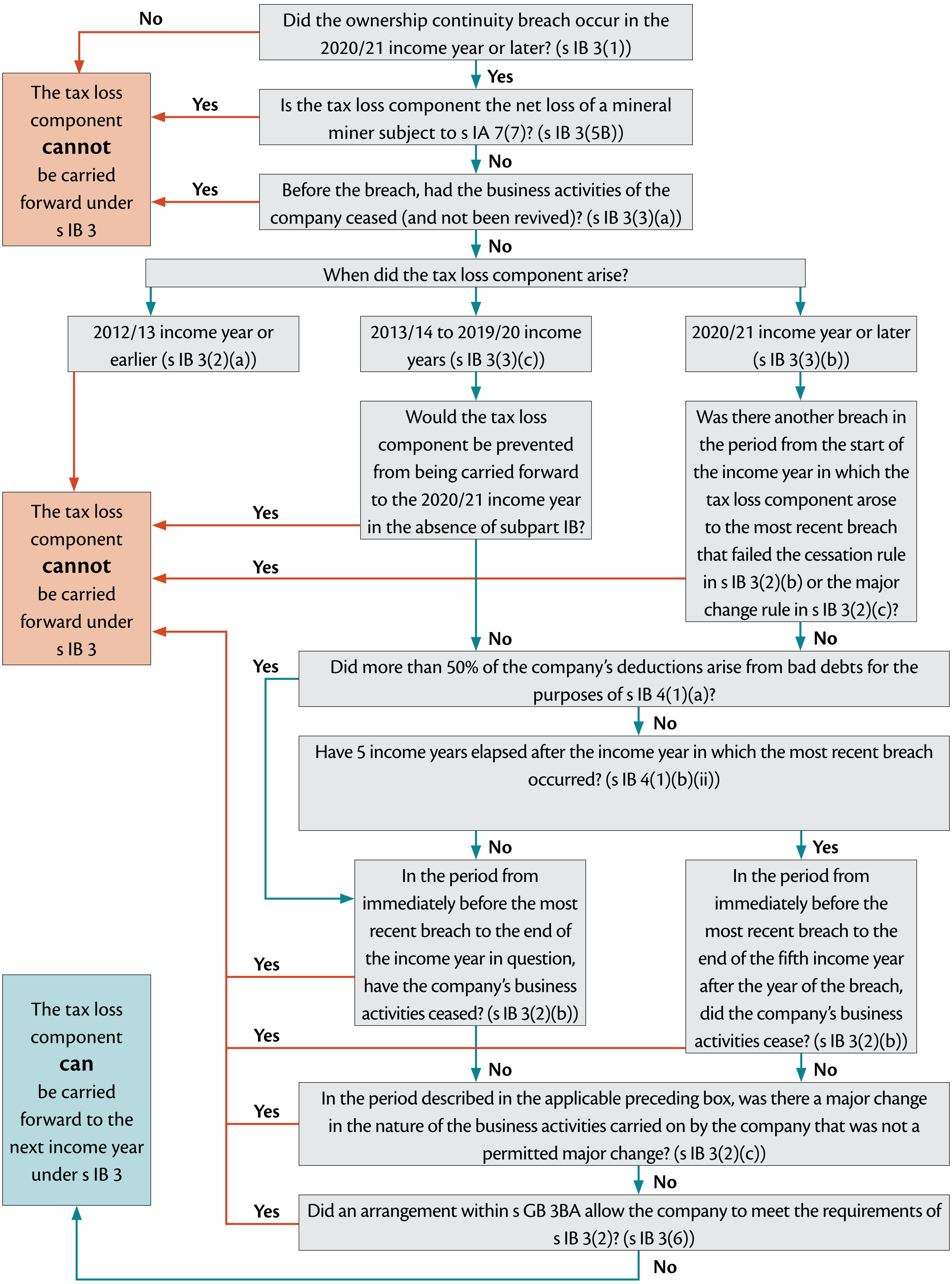
109. For the purposes of s IB 3(3)(a) and IB 3(2)(b), a temporary cessation will **not** constitute a cessation of business activities. In contrast, cessation with the possibility of recommencement will constitute a cessation.

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).

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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.

IS 22/07: Company losses – ownership continuity, sharing and measurement

This Interpretation Statement considers the rules applying to company losses, including carrying forward losses, sharing losses and the measurement of ownership interests.

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

Unless otherwise stated, examples in this statement are to be read independently of each other.

Overview

1. The loss rules allow a company (a **loss company**[1]) to:
   - carry forward a tax loss to a subsequent tax year – where it will be used to reduce the loss company's net income (if any) or be added to the tax loss for the subsequent tax year;[2] or
   - share a tax loss with a **profit company** in a group of companies.
2. Losses can be used in other ways too (see [43]).

Important concepts: "tax loss" and "tax loss component"

3. An important concept in the loss rules is a **tax loss**. This is essentially the total loss amount for the tax year that can be carried forward or shared. The tax loss concept is described at [33].
4. A tax loss is made up of **tax loss components**. An example of a tax loss component is a net loss[3] from a previous tax year that has been carried forward to the current tax year.
5. Tax loss component is an important concept because key requirements of the loss rules need to be tested for each tax loss component. Tax loss components must also be used in the order in which they arose. The tax loss component concept is described at [38].

Carrying forward a tax loss

6. To carry forward a tax loss one of the following types of continuity must be satisfied:
   - at least 49% continuity in the ownership of the loss company (**ownership continuity**), which is discussed further at [51];
   - continuity of the business activities of the loss company (**business continuity**).[4]
7. Continuity must be tested for each tax loss component and must be maintained for the **continuity period** applying to that component. The continuity period is essentially the period from the start of the income year in which the tax loss component arose to the end of the income year in which the loss is used.[5]

[1] The terms "loss company" and "profit company" are generally not used in the loss rules anymore (they were previously used extensively, but now only feature in a certain anti-avoidance provisions). Nevertheless, for the purposes of this statement the term "loss company" means a company that has a tax loss component that it can use, and "profit company" means a company that has net income (as modified by the loss rules).

[2] There is a temporary rule introduced as a COVID-19 pandemic response that allows a tax loss for the 2020 or 2021 tax year to be carried back. This rule is not discussed further in this Interpretation Statement.

[3] A person's "net loss" for a tax year is the difference between the person's annual total deductions and their annual gross income (ie, where the annual total deductions are higher).

[4] The business continuity test is discussed in a separate Interpretation Statement: IS 22/06 "Loss carry-forward – continuity of business activities".

[5] For the purposes of sharing losses, this period is extended to the end of the profit company's income year if the profit company has a later balance date.

Sharing a tax loss with another company

8. Two of the main requirements that must be met for a tax loss to be shared with another company are as follows:
   - The loss company must satisfy one of the continuity requirements discussed above.
   - An **ownership commonality** requirement must be satisfied. Essentially, this requirement is that there is a group of people who each hold ownership interests in the loss and profit companies and the total of each person's lowest interest of the interests in the two companies (their common ownership interest) is at least 66%. This requirement must be tested for each tax loss component and be satisfied for the commonality period applying to that tax loss component.
9. The requirements are discussed in more detail from [61].
10. A profit company must use a tax loss that is shared with it to reduce its net income. The profit company cannot carry the loss forward, share the loss with another company or use the loss in any other way.[6]
11. The amount of tax loss that can be shared is limited by the profit company's net income. The meaning of net income is modified for this purpose. This is discussed at [93].
12. The loss rules recognise that losses may be shared with or without consideration. The rules provide that a payment made for a loss (a subvention payment) will not be a dividend (that is, in situations where the loss company is a shareholder of the profit company).
13. A loss company and a profit company may have income years with different balance dates. This will mean that for a tax year (a tax year always ends on 31 March), the net loss of a loss company and the net profit of a profit company will be calculated based on income years that do not precisely match. This mismatch will normally not affect the amount of tax loss that can be shared with the profit company.[7]

Measurement of ownership interests

14. The ownership continuity and commonality requirements require a loss company to keep track of changes in the ownership of the loss company and (when sharing losses) profit companies.
15. There are two types of ownership interests:
   - voting interests; and
   - market value interests.
16. In most cases, it will be necessary to consider only voting interests. However, if there is a market value circumstance, it is necessary to measure both voting and market value interests.
17. There are detailed rules about how to measure these ownership interests (including a look-through rule). These are discussed from [114].

Part-year rules

18. The part-year rules[8] recognise that part way through an income year an event (for example, a change in the shareholding of a loss company) could result in ownership continuity or commonality being breached[9] or established[10] for a tax loss component and a group of persons.
19. In the absence of the part-year rules, if there was a continuity or commonality event part way through the income year, this could prevent a tax loss component from being used for the income year, or from being carried forward.
20. The part-year rules ensure that, in these cases, certain losses can still be used in the relevant part-year periods. This is consistent with the purpose of the loss rules (to ensure that, largely, losses are available to be used by the people who ultimately incurred the losses) and avoids an outcome that would otherwise follow from the assessment of income tax on an annualised basis.

[6] However, in a wholly owned group, a tax loss of a loss company can be used to satisfy a shortfall penalty.

[7] However, the difference in balance dates can limit the amount that can be shared where there is a breach of continuity or commonality as the balance dates will constrain the period (referred to in the Act as a **common span**) for which losses can be shared.

[8] The part-year rules are contained in subpart IP.

[9] For tax loss components in the income year and in previous income years.

[10] For part of the net loss for the tax year.

21. Generally, a tax loss component that relates to a pre-breach period[11] can be used to reduce the loss company's net income in the pre-breach period and, if sharing requirements are satisfied, an amount of the profit company's net income.[12]
22. A tax loss component (a net loss) that relates to a part-year period following a continuity breach, or following the establishment of commonality between two companies (post-establishment period), can be carried forward by the loss company or shared with a profit company. The profit company can apply this part-year loss against an amount of its net income.[13]
23. The part-year rules are discussed in more detail from [197].

Amended assessments and consequential loss adjustments

24. If the Commissioner makes an amendment to the assessment of a loss company or a profit company, this can lead to consequential loss adjustments (in the assessments of subsequent income years or in the assessments of other companies). Many different scenarios can arise because:
    - the amended assessments could result in tax loss or net income being increased or decreased;
    - sharing losses depends on both the level of the loss company's tax loss and the profit company's net income (see [11]);
    - the loss company may or may not have used or shared all its tax loss;
    - reduced tax losses may need to be reallocated among multiple profit companies; and
    - where a tax loss has been transferred by subvention payment and the tax loss is reduced, the subvention payment may be treated as a dividend.[14]
25. The effect of amended assessments on losses is discussed in more detail from [246].

Special rules apply to certain types of loss

26. This Interpretation Statement considers the general loss rules in part I of the ITA 2007.
27. Special rules, outside the scope of this Interpretation Statement, also apply to:
    - ring-fenced tax losses including some net losses of mineral miners, attributed CFC net losses, FIF net losses, and PIE net losses;
    - loss offsets on an amalgamation or for a consolidated tax group;
    - pre-1993 losses;
    - deferred deductions (technically not losses) from residential rental properties; and
    - for life insurers, policyholder base excess deductions.

Other rules

28. Some points to note about losses and other rules in the Act are set out below.

The look-through company rules

29. In relation to the look-through company rules,[15] losses are treated as being incurred by "look-through counted owners", rather than by the look-through company. There are also specific rules about what happens to losses when a company becomes a look-through company.

[11] Including a previous income year or the part-year period in the year of the breach.

[12] The net income of the profit company that can be reduced is limited to the lower of the profit company's whole-year net income and the net income calculated for a part-year period corresponding with the pre-breach period (called the common span).

[13] The net income of the profit company that can be reduced is limited to the lower of the profit company's whole-year net income and the net income calculated for a part-year period corresponding to the post-establishment period (also called a common span).

[14] This can be avoided if the subvention payment is repaid.

[15] Subpart HB.

The qualifying company rules

30. The qualifying company rules contain rules about losses incurred by a company before becoming a qualifying company.[16] There is also a rule that prevents a qualifying company from receiving losses a from loss company in the same group of companies if the loss company is not also a qualifying company. However, going the other way, there is no rule preventing a qualifying company from sharing its losses with a non-qualifying company.
31. The qualifying company rules also contain a special 50% continuity requirement that must be met for a company to retain its status as a qualifying company.[17]

Research and development loss tax credit rules

32. Under research and development loss tax credit rules an eligible company can apply to convert tax losses into refundable tax credits.[18] These rules were introduced in 2015 (effective from the 2016 tax year) as part of a Business Growth Agenda designed to encourage business growth and confidence. When a loss amount is converted, Inland Revenue will issue an amended assessment that will show a reduced loss balance.

Important concepts

Tax loss

33. A **tax loss** is an important concept in the loss rules. It is essentially the total loss amount for the tax year that a loss company can share or carry forward to the subsequent tax year.
34. A loss company's "tax loss" for a tax year comprises:
    - the **loss balance carried forward** to the tax year;
    - as relevant:
        - *less* the loss company's **net income** for the tax year, or
        - *plus* the loss company's **net loss** for the tax year;[19]
    - *plus* various other amounts listed in s IA 2(4).
35. A loss balance carried forward to a tax year is usually[20] the tax loss for the preceding tax year that was not used in that year.[21] The unused tax loss for the preceding tax year may include tax loss components that had been carried forward from earlier tax years. The loss balance carried forward to a tax year must be applied against the net income (if any) of the loss company for the tax year.
36. A person has **net income** for the tax year if their annual gross income is greater than their annual total deductions. A person has a **net loss** for the tax year if their annual total deductions are greater than their annual gross income.[22]

Tax loss component

37. A tax loss is made up of **tax loss components**. The concept of a tax loss component is important because continuity and commonality requirements must be tested for each component. Also, tax loss components included in a tax loss must be used in the order in which they arose.
38. Tax loss components include:
    - net losses from previous tax years (included in the loss balance carried forward to the tax year);

[16] Subpart HA. The qualifying company regime was superseded by the look-through company regime with application to income years beginning on or after 1 April 2011. Companies are no longer able to elect into the qualifying company regime from this date, however, existing qualifying companies can continue to operate under the regime.

[17] See s HC 6(3).

[18] Subpart MX.

[19] A person's "net loss" for a tax year is the difference between the person's annual total deductions and their annual gross income (ie, where the annual total deductions exceed the annual gross income).

[20] Where there is a breach of continuity in the tax year the loss balance that can be carried forward to the tax year may be limited. This is discussed below in the discussion of the "Part-year rules".

[21] Section IA 3(4). The main way that a company can use a tax loss is by sharing it with a group company (s IA 3(2)). A tax loss can also be used to pay shortfall penalties (IA 3(1)) or to reduce the amount of a taxable distribution received from a non-complying trust (s IA 3(3)).

[22] Section BC 4.

- the loss company's net loss for the tax year (if any);
- certain additional amounts listed in s IA 2(4), for example, an amount of converted imputation credits arising under s LE 2; and
- certain losses arising before the 2009 income year that the loss company was entitled to carry forward under previous legislation.

Other terms distinguished

39. The concept of a tax loss can be distinguished from the following loss concepts:

- **Available tax loss** describes the loss that can be subtracted from a company's net income to determine its taxable income. An available tax loss for a tax year includes the company's loss balance carried forward to the tax year (which is the unused tax loss from the previous year), losses that have been shared with (or "made available to") the company by other group companies, and various other amounts.
- **Loss balance** is essentially the tax loss for a tax year that is not used. It generally becomes the **loss balance carried forward** for the following tax year.[23]
- **Loss** is a term used to describe a depreciation loss or certain losses related to the CFC and FIF rules. It is also commonly used in a general sense when referring to the different loss concepts in the Act.

How a loss can be used

40. A loss balance carried forward to a tax year must first be used to reduce the net income (if any) of the loss company for the tax year.[24] The use of a loss balance carried forward to reduce net income is subject to continuity requirements (discussed from [48]) being met. Also, for some types of schedular income, a tax loss cannot be used to reduce a loss company's schedular income tax liability.[25]

41. Any remaining loss balance carried forward (after the loss balance is used to reduce any net income of the loss company) forms part of the tax loss for the tax year.

42. The main way in which a tax loss for a tax year can be used is by sharing it with another company in the same group of companies.

43. A tax loss can also be used in the following ways:

- A loss company can use its tax loss to pay a shortfall penalty for which it is liable.[26] This is restricted to shortfall penalties that arise from a tax position taken in relation to income tax.[27] For a company, the amount by which the penalty is reduced is equal to the company tax rate multiplied by the tax loss that is used. For example, a company could pay a shortfall penalty of $28,000 using $100,000 of tax loss (at the current 28% company tax rate). The loss company must notify the Commissioner that it wishes to use the tax loss in this way by the due date for the payment of the penalty.[28]
- Similarly, in only a wholly-owned group, the tax loss of a loss company can be used to pay the shortfall penalty of another company in the group.[29]
- Where the loss company is a beneficiary of a non-complying trust and has derived a taxable distribution from the trust, the loss company can use its tax loss to reduce the taxable distribution.[30]

[23] Unless there is a breach in the following tax year, in which case the amount that can be carried forward may be limited. See the discussion of the part-year rules later in this Interpretation Statement.

[24] This is part of the calculation of a person's "taxable income" under the core provisions of the Act. Under s BC 5 a person's taxable income is calculated by subtracting any available tax loss from their net income. A loss balance carried forward to a tax year is part of a person's available tax loss (s YA 1).

[25] This prohibition is in s IA 8, which also lists the types of schedular income to which the prohibition applies. These include life insurers' schedular policyholder base income, non-resident passive income for filing taxpayers described in s RB 3, income of non-resident shippers, income of non-resident general insurers, and income subject to an arrangement described in s GB 3BAB. The calculation of schedular income tax liability is in s BC 7. The approach taken to this type of schedular income is to isolate it and calculate what would be the income tax liability of the person if the schedular income was the only income the person derived in that year.

[26] Section IA 3(1). See SPS 16/04: Payment of shortfall penalty using losses (October 2016) for further guidance.

[27] Section IW 1(1).

[28] You can notify the Commissioner using MyIR or in the other usual ways listed on our website (Contact us).

[29] "Wholly-owned group" is defined in s IC 4. Essentially, a wholly-owned group means 2 or more companies in relation to which a group of persons holds ownership interests that total 100%. However, the definition includes an exception to the 100% ownership requirement to cater for small (no more than 3%) ownership interests related to employee share purchase schemes.

[30] Section IA 3(3).

44. Tax loss components must be used in the order in which they arose.[31] For example, the net loss arising for the 2015 income year (being a tax loss component) must be used before the net loss for the 2018 income year (being another tax loss component). Where a loss company wishes to share a loss with a profit company,[32] this ordering rule applies to the tax loss components that can be shared between the two companies. For example, if a loss company and a profit company have a commonality period[33] that begins at the start of the 2017 income year, and the loss company has one tax loss component from the 2015 income year and another from the 2017 income year, the tax loss component from the 2017 income year can be shared with the profit company even if the loss company has not yet used the tax loss component from the 2015 income year.

45. Any tax loss that is not used for the tax year is carried forward to the next tax year as a loss balance (subject to continuity requirements being met).

46. A temporary rule (part of the COVID-19 pandemic response) allows a tax loss for the 2020 or 2021 tax years to be carried back. This rule is discussed in:
    - "COVID-19 Response (Taxation and Other Regulatory Urgent Measures) Act 2020", *Tax Information Bulletin* Vol 32, No 7 (August 2020): 4; and
    - Inland Revenue, **COVID-19 Temporary loss carry-back scheme** (website last updated 12 July 2021).

Carrying forward a tax loss

47. As noted above, the balance of a tax loss that is not used in a tax year can be carried forward to the following tax year. This is subject to continuity requirements being met for the tax loss components that make up the balance of the tax loss.[34]

Continuity tests

48. There are two continuity tests:
    - the ownership continuity test; and
    - the business continuity test.

49. At least one of these tests must be satisfied to carry forward a loss.

50. Continuity is tested for each tax loss component and must be maintained for the **continuity period** applying to each tax loss component. The continuity period is essentially the period from the start of the income year that the tax loss component arose to the end of the income year in which the tax loss component is used.[35]

Ownership continuity test

51. The ownership continuity test requires that there is 49% continuity in the ownership of the loss company (**ownership continuity**) over the continuity period.

52. Ownership interests are measured in two ways:
    - voting interests;
    - market value interests

53. In most cases, it will be necessary to consider only voting interests. However, if there is a market value circumstance, it is necessary to consider both voting and market value interests.

54. There are also many rules that affect the measurement of the ownership interests. For example, there are rules that require looking through chains of ownership. These rules and the terms voting interests and market value interests are discussed together (from [119]).

[31] Section IA 9.

[32] Sharing of losses is discussed from [55].

[33] See [76].

[34] Sections IA 3(4) and IA 5.

[35] For the purposes of sharing losses, this period may be extended to the end of the profit company's income year, if it has a later balance date.

55. Continuity of ownership is determined by identifying the lowest ownership interest[36] held by an owner during the continuity period. If there is a group of persons[37] whose lowest ownership interests total at least 49%, then the continuity requirement is met. This is illustrated in Example 1.

Unless stated otherwise examples in this Interpretation Statement are intended to be read independently of each other (that is, facts in one example are not relevant to other examples). The company names "Loss Co" and "Profit Co" are used in many of the examples (and some figures) to reinforce the roles of the companies.

Example 1 - Identifying the lowest ownership interests over the continuity period

Loss Co had a net loss for the 2015 income year of $100,000. It wishes to use this loss to reduce net income that it has for the 2023 income year.

Loss Co has always had a standard balance date.

The continuity period for the 2015 net loss, and for the proposed use in the 2023 income year, is the nine-year period:

- beginning on 1 April 2014; and
- ending on 31 March 2023.

No market value circumstance occurred during the period, so it is necessary to consider only voting interests.

Two shareholding changes occurred over this nine-year period: on 23 November 2018 and 4 October 2020. This is illustrated in the following table[38]

	Voting interests as at 1/4/2014	Voting interests as at 23/11/2018	Voting interests as at 04/10/2020	Lowest voting interest
Shareholder 1	50%	50%	25%	25%
Shareholder 2	50%	25%	25%	25%
Shareholder 3	0%	25%	50%	0%
Total				**50%**

Loss Co will be able to carry forward the 2015 net loss of $100,000 to the 2023 income year. This is because the total of Shareholder 1 and Shareholder 2's lowest voting interests over the continuity period is 50%, which is more than the required 49% ownership continuity. Shareholder 3's lowest voting interest during the continuity period is 0% as it did not hold any shares at the beginning of the period.

Business continuity test

56. The business continuity test is generally concerned with continuity of the nature of the business activities of the loss company, rather than continuity of ownership.[39]

57. This test applies when a company fails the ownership continuity test.

58. This test is discussed in a separate Interpretation Statement: **IS 22/06** "Loss carry-forward – continuity of business activities".

To avoid complicating the facts, examples in this Interpretation Statement do not take into account any possible reliance on the business continuity test and look solely at the ownership continuity tests where relevant.

[36] The Act uses the terms "minimum voting interest" and "minimum market value interest".

[37] Or it could be just one person.

[38] This table shows the calculation of the lowest voting interest for the nine-year continuity period. In calculating this amount, it is sufficient to consider the voting interests on only the dates shown in the table. However, a loss company is also required to provide similar information on an annual basis in its company income tax return (IR4). The return requires a loss company to enter the total lowest economic interests of shareholders during the income year. In the 2022 version of the IR4, this was required by question 41. For example, the total lowest economic interests of the shareholders in Loss Co during the 2019 income year would have been 75% (shareholder 1's interest was 50% for the entire income year, shareholder 2's interest decreased to 25% during the income year and shareholder 3's interest was 0% at the beginning of the income year).

[39] The rules concerning the business continuity test are in subpart IB.

Anti-avoidance rules

59. Anti-avoidance rules may apply in relation to arrangements that use or circumvent the continuity rules.[40] These rules are not discussed in detail in this Interpretation Statement. However, a common feature of the rules is that they apply where there is an arrangement and a purpose of the arrangement is to defeat the intent and application of the loss continuity rules or, in the case of some of the provisions, where the arrangement has tax avoidance as its sole or main purpose.

Sharing losses

60. A loss company can share its **tax loss** with a profit company if the requirements listed in [61] are met.

Requirements that need to be met to share losses

61. A loss company can share a tax loss with a profit company only if:[41]
    - the loss company meets loss company place requirements;[42]
    - notification and payment requirements are met;[43]
    - the loss company meets a continuity requirement;[44] and
    - the profit company and the loss company meet ownership commonality requirements.[45]

Loss company place of incorporation or carrying on business

62. The loss company must, for the **commonality period**, be either:
    - incorporated in New Zealand; or
    - carrying on a business in New Zealand through a fixed establishment in New Zealand.
63. The second point above means that a branch of an overseas company can be a loss company (if it is carrying on business in New Zealand through a fixed establishment here). Generally, "fixed establishment" means a fixed place of business in which substantial business is carried on by a person.[46]
64. In relation to the first point above, for a company incorporated in New Zealand, there is an additional requirement.[47] That is, the company must, for the commonality period, not be:
    - treated as not resident in New Zealand by and for the purposes of a double tax agreement (**DTA**); or
    - liable for income tax in, and under the law of, another country or territory because of domicile, residence, or place of incorporation.
65. In other words, a dual-resident company cannot share a tax loss under the loss rules.
66. The loss company place requirement is illustrated in Figure 1.
67. The residence of the profit company is not important. The profit company may be a non-resident.[48]

[40] Sections GB 3, GB 3BA, GB 3BAB, GB 3BAC and GB 3B.

[41] Section IC 5(1).

[42] See s IC 7.

[43] See s IC 9.

[44] See s IC 2(1).

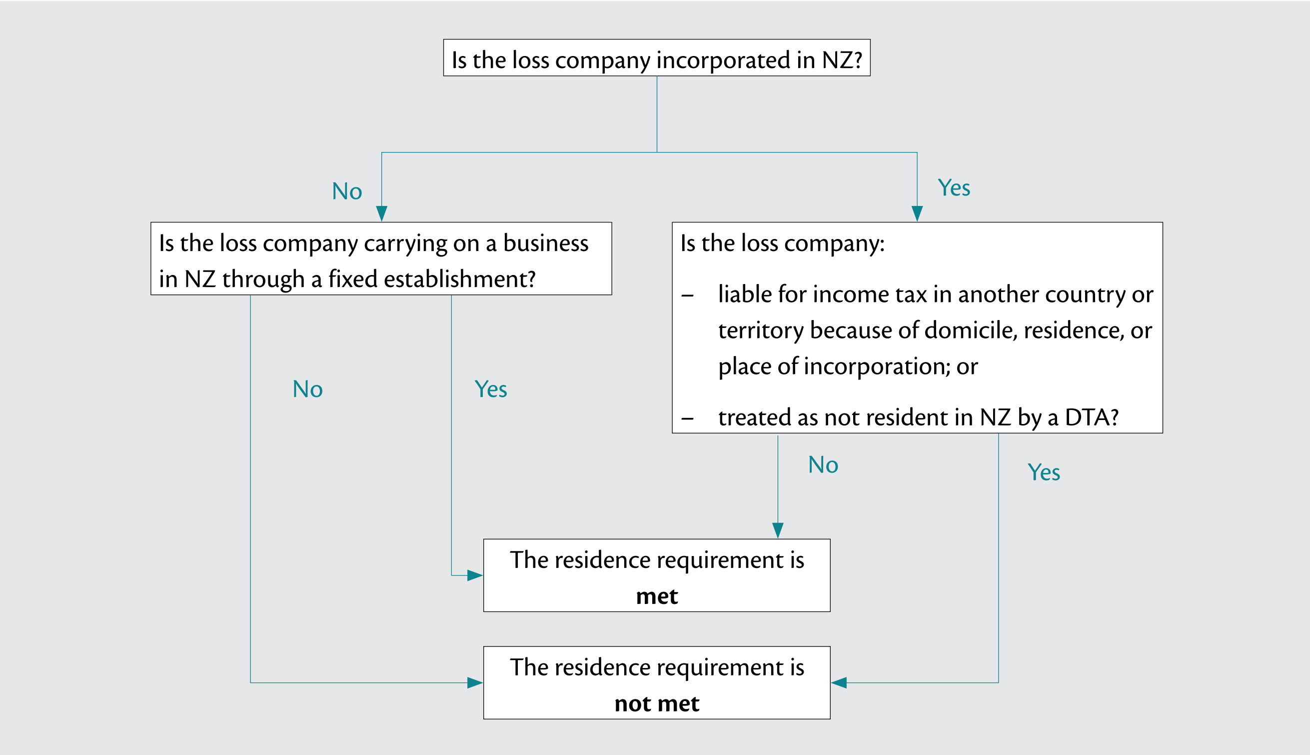
[45] See s IC 6.

[46] Definition of "fixed establishment" in s YA 1. The definition of "fixed establishment" also has specific inclusions and exclusions.

[47] Note that at the time of writing there was an amendment proposed to repeal this additional requirement. See Taxation (Annual Rates for 2022–23, Platform Economy, and Remedial Matters) Bill (No 2): cl 78.

[48] *CIR v Alcan NZ Ltd* [1994] 3 NZLR 439 (CA).

Figure 1 - Loss company place requirement



Notification and payment requirements

68. A loss company must notify the Commissioner that a loss has been shared (whether by election or subvention payment) by:

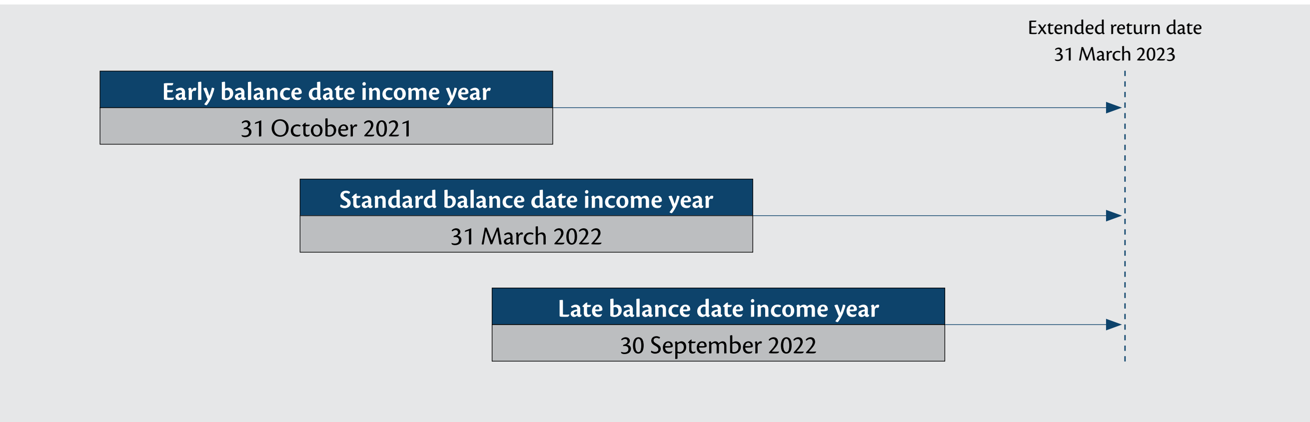
- the **extended return date**, or
- by a later date, if allowed by the Commissioner.[49]

69. Also, a profit company that makes a subvention payment must make the subvention payment by the above dates.

70. The extended return date is 31 March of the tax year following the tax year for which the tax loss is being shared. This date is the same whether the loss company has an early, standard, or late balance date. This is illustrated in Figure 2.

71. For more guidance on the notification requirements, including the Commissioner's policy on accepting late elections, see SPS 20/02: Loss offset elections between group companies.

Figure 2 - Extended return date for different balance dates



[49] Section IC 9.

Continuity requirements

72. To share a tax loss component with a profit company, the loss company must meet one of the ownership or business continuity requirements for the tax loss component. The continuity requirements are discussed above from [13]. As discussed above, a continuity requirement must be satisfied for the continuity period that applies to the tax loss component.

Continuity period extended for the purposes of loss sharing

73. Usually, a continuity period ends on the last day of the loss company's income year. However, the continuity period may be extended in the context of sharing a loss.

74. For the purposes of sharing, the **continuity period** for a tax loss component is the period:[50]

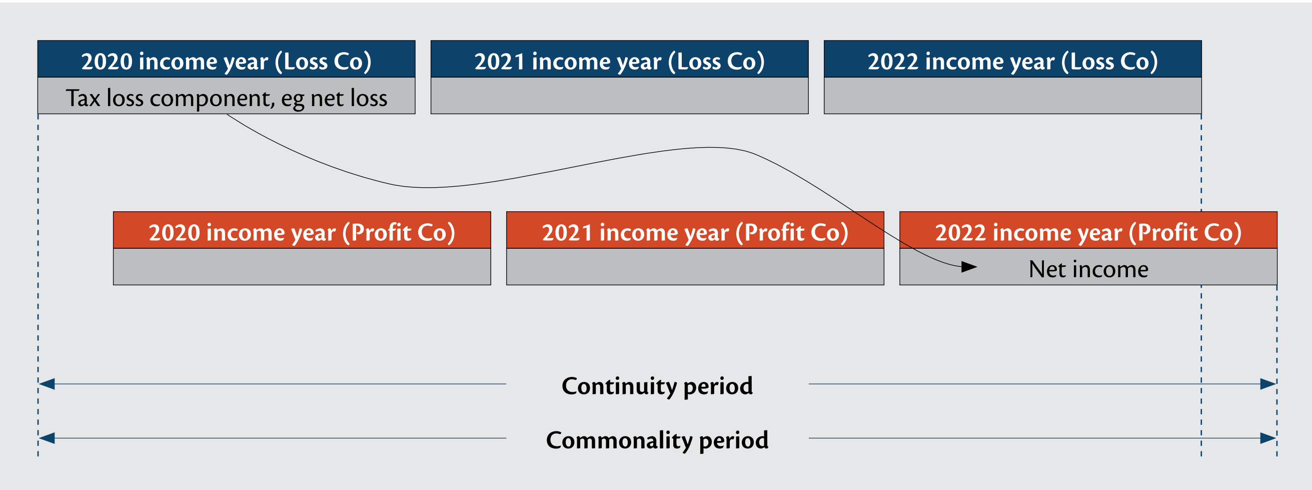
- from the start of the loss company's income year in relation to which the tax loss component arose;
- to the end of the loss company's income year (or the profit company's income year if it has a later balance date)[51] in relation to which the loss company wishes to use the tax loss component.

75. The extension of the continuity period is consistent with the general principle that a tax loss should be available for use only if continuity has been maintained until the end of the period in which the tax loss is sought to be used.

76. The **commonality period** (discussed further below) will be the same as the continuity period.

77. In Figure 3, the tax loss component arising from the 2020 income year is carried forward and not used until the 2022 income year. The figure shows that Profit Co has a later balance date and that this extends the continuity and commonality periods that would apply in considering whether the loss can be carried forward and shared.

Figure 3 - Extension of continuity period for the purposes of sharing losses



Commonality requirement

78. To share a tax loss component, the commonality requirement must also be satisfied.

79. Before discussing the substance of the requirement, it is noted that the commonality requirement must be satisfied at all times during the "commonality period" for the tax loss component. The commonality period is similar to the continuity period (see [73]). The **commonality period** for a tax loss component is the period:

- from the start of the loss company's income year for which the tax loss component arose;
- to the end of the loss company's income year (or the profit company's income year if it has a later balance date)[52] in relation to which the loss company wishes to share the tax loss component.

[50] Section IA 5(6).

[51] Section s IC 10.

[52] Section s IC 10.

80. The requirement for the commonality requirement to be met at all times during the commonality period means that:

- it is important to consider when a company was incorporated or when it became a member of the group of companies;[53] a company will not be able to benefit from a tax loss component from a group of companies if that tax loss component arose before company joined the group; and
- it is necessary to test commonality at particular times during the commonality period when there are ownership changes.

81. The substantive commonality requirement, applied at a particular time, can be summarised below:

- The commonality requirement requires consideration of people who hold ownership interests[54] in both the loss company and the profit company.
- For a person with an ownership interest in both companies, the commonality requirement requires the identification of the lowest of the interests held by the person in the two companies. For example, if at a particular time a person holds a 10% ownership interest in the loss company and a 15% interest in the profit company, their lowest interest in the two companies at that time is 10%.
- The commonality requirement requires that there is a group of people (which can include a single person) whose lowest interests (as described above) total at least 66%.[55]

82. The substantive commonality requirement described in the points above is to establish commonality at a particular time and is illustrated in Example 2.

83. Because the commonality requirement requires that commonality is maintained at all times during the commonality period, the above test may need to be repeated at different times; that is, when there are ownership changes.

84. Different tax loss components will generally have different commonality periods and, therefore, may need to be tested separately, depending on the timing of ownership changes.

Example 2 – Calculating the total of the lowest common voting interests

On 31 March 2022, Loss Co and Profit Co were owned by Carolyn, Rhys and Leia in the following proportions:

Owner	Loss Co	Profit Co	Lowest common voting interest
Carolyn	25%	50%	25%
Rhys	25%	25%	25%
Leia	50%	25%	25%
	100%	100%	75%

In the above table, the lowest common voting interest for each person in the two companies is identified in the fourth column. The interest is common in the sense that at least that percentage is held in both companies. These lowest common voting interests are then totalled. The table shows that Carolyn, Rhys and Leia are a group of people who at a point in time (31 March 2022) have 75% commonality of ownership over Loss Co and Profit Co.

If, during the commonality period for a tax loss component, the ownership of the companies changes, the same exercise will need to be repeated at different times to ensure the commonality of ownership is at least 66% at all times during the commonality period.

[53] "Group of companies" has a specific meaning in the loss rules. Companies for which the commonality requirement are satisfied are referred to as companies in a "group of companies". Section IC 3(1). Note that the term "group of companies" excludes situations where the companies are multi-rate or listed PIEs.

[54] For the ownership interests, it will usually be sufficient to consider voting interests. However, if there is a market value circumstance, it will also be necessary to consider market value interests.

[55] It is important to note that this test (which starts by examining the commonality at the individual level) produces a different result from that produced by considering the common ownership interests of the group of persons at the group level.

Group of persons can change during a commonality period

85. It is not necessary that the group of persons holding the common ownership interests stays the same for the whole of the commonality period.[56] The focus of the ownership commonality requirement is on the ownership of the loss company and profit company being common, not on the identity of the owners. This is illustrated in Example 3.

Example 3 – Commonality – the group of persons can change

Following on from Example 2, Diya purchases Leia's shares in **both** Loss Co and Profit Co. This leads to there being a new "group of persons". Diya maintains the same level of commonality because she purchased Leia's shares in both Loss Co and Profit Co:

Owner	Loss Co	Profit Co	Lowest common voting interest
Carolyn	25%	50%	25%
Rhys	25%	25%	25%
Leia	0%	0%	0%
Diya	50%	25%	25%
	100%	100%	75%

Commonality would be breached if Diya subsequently sold her shares in the Loss Co. This is because her individual common ownership interest in Loss Co and Profit Co would be zero:

Owner	Loss Co	Profit Co	Lowest common voting interest
Carolyn	25%	50%	25%
Rhys	25%	25%	25%
Leia	0%	0%	0%
Diya	0%	25%	0%
	100%	100%	50%

86. Although the group of persons can change for the commonality requirement, to share a loss a loss company must maintain ownership continuity of at least 49% during the continuity period (or satisfy the business continuity requirement). For the ownership continuity requirement, there must be a group of persons who at all times during the continuity period have ownership interests that total at least 49%. For example, if during a commonality/continuity period, 52% of the shares in both the loss and profit companies were transferred to an entirely new owner, the 66% commonality requirement would be met but the 49% ownership continuity requirement would not be met.

87. Note that the focus of Example 2 and Example 3 is to illustrate the calculations required for the commonality test, rather than the continuity test. More information would be needed for the companies in the examples to determine whether the continuity test was satisfied for a particular tax loss component (the examples do not identify a particular tax loss component or continuity period to be tested for continuity). However, the facts of the examples would not necessarily result in a continuity breach as the shareholding change in Loss Co was only 50%.

88. Wholly-owned groups are subject to the same commonality requirement as other groups. In particular, it is important to consider when a company in the group was incorporated or when it became a member of the group.

Measurement of common ownership interests

89. The commonality test, like the continuity test, requires a company to keep track of ownership changes. The rules relating to the measurement of ownership interests are discussed from [119].

[56] Section IC 3(2).

Anti-avoidance rule

90. An anti-avoidance rule may apply to treat a company as not meeting the loss grouping requirements.[57] This rule applies when:

- an arrangement exists that allows a company (**offset company**[58]) to meet the requirements of certain loss-sharing provisions;[59]
- a share in the offset company or another company has been subject to the arrangement; and
- a purpose of the arrangement is to defeat the intent and application of the loss sharing provisions.

Special rules apply for certain entities

91. Special loss sharing rules apply for:

- mixed ownership enterprises (these are certain listed enterprises that the Government owns in part);[60]
- multi-rate, listed or foreign investment PIEs;[61]
- losses incurred in connection with development work in Niue.[62]

Company trustee cannot share losses

92. A company acting in the capacity as a trustee cannot share losses incurred in that capacity with another company in the same group. This is because s IA 3 (which permits sharing by a loss company) uses the term "company" and this term is defined in s YA 1 to not include a company when acting in its capacity as a trustee.

Limitations on sharing

Amount that can shared is limited by the profit company's net income as modified by the loss rules

93. The amount that can be shared with a profit company is limited to the profit company's net income modified as described below.[63]

Profit company's modified net income

94. A profit company's net income[64] is modified for the purposes of the loss grouping provisions by subtracting:[65]

- the profit company's own losses (that is, any loss balance the profit company has carried forward to the tax year); then
- a tax loss made available to the profit company by another company, which ensures the total of the losses made available to the profit company by the loss company and any other companies does not exceed the net income of the profit company.

95. The calculation of net income doesn't usually involve tax losses. Usually, it is only in calculating "taxable income" that losses become part of the calculation. Taxable income is calculated by subtracting any "available tax loss"[66] from net income.[67]

Profit company must use the loss to reduce its net income

96. The profit company must use the loss to reduce its net income.[68] The profit company cannot carry forward the loss, share the loss further, or use the loss in any other way.[69]

[57] Section GB 4.

[58] This could be a loss company or a profit company.

[59] Subparts IC and IP, and ss IZ 7 and IZ 8.

[60] Section IC 3(2A).

[61] Section IC 3(2B), (2C), and (2D).

[62] Section IC 13.

[63] Section IC 8(1) and (2).

[64] Net income is the difference between annual gross income and annual total deduction (s BC 4).

[65] Section IC 8(3).

[66] "Available tax loss" is discussed at [35].

[67] Section BC 5.

[68] Section IC 5(1) and (3).

[69] The only exception to this is if a company in a wholly-owned group has a tax loss for a tax year, the amount of the tax loss may be used to pay a shortfall penalty of another company in the wholly owned group (s IW 1).

Loss and profit companies can have different balance dates

97. A loss company and a profit company may have income years with different balance dates. This will mean that for a tax year (a tax year always ends on 31 March), the net loss of a loss company and the net profit of a profit company will be calculated based on income years that do not precisely match. This mismatch will not usually affect the amount of tax loss that can be shared with the profit company.[70] However, if the profit company has a later balance date, continuity and commonality requirements must be maintained until the end of the profit company's income year.[71]

Amount that can be shared is limited by certain deductions for bad debts or decline in share value

98. The amount of tax loss that a loss company can share is limited if the:[72]
    - tax loss includes a tax loss component (for example, a net loss) that arose from expenditure that was funded by a loan from another company in the group (the **write-off company**);[73] and
    - write-off company has taken a bad debt deduction for the loan.

99. In this case, the amount of tax loss that the loss company can share is limited by the amount of the write-off company's bad debt deduction. This is illustrated in Example 4.

Example 4 - Sharing of loss limited by bad debt deduction

Loss Co and Group Finance Co are in the same group of companies. Loss Co borrows $10,000 from Group Finance Co (which is in the business of lending money) to cover rental payments on Loss Co's business premises. The amount was lent under a facility that is a "variable principal debt instrument" and the total value on every day in the income year of all variable principal debt instruments was $50,000 or less (this fact is relevant to Group Finance Co's ability to claim a deduction as discussed further below).

Loss Co uses the money to pay its rent and claims a deduction for the expenditure in its return for the 2023 income year.

Loss Co makes a net loss of $15,000 for the 2023 income year.

Group Finance Co writes off the $10,000 loan as a bad debt on 31 March 2023 and claims a bad debt deduction in its return for the 2023 income year.

Loss Co wishes to share its $15,000 loss with Profit Co, which has net income of $100,000 for the 2023 income year.

Loss Co, Group Finance Co and Profit Co all have standard balance dates and are all part of a group of companies (the commonality requirement is satisfied for the commonality period applying to the net loss; that is, during the 2023 income year).

The amount that Loss Co can share with Profit Co is limited to $5,000. The remaining loss of $10,000 cannot be shared because Group Finance Co is in the same group of companies and took a deduction for the written off loan that was used to pay for some of the expenditure that led to the net loss.

Loss Co can still carry forward the remaining loss of $10,000 and use it to reduce any net income it may have in subsequent income years.

100. A similar rule applies where:[74]
    - the tax loss includes a tax loss component (for example, a net loss) that arose from expenditure that was funded by the loss company issuing shares; and
    - a company (the **write-off company**) in the same group of companies has taken a deduction for a decline in the value of the shares issued by the loss company.[75]

[70] The difference in balance dates can limit the amount that can be shared where there is a breach of continuity or commonality as the balance dates will limit the **common span**.

[71] Section IC 10.

[72] Section IC 12.

[73] The loss company's expenditure does not need to have been directly funded by the loan. For example, the Write-off company could have lent the money to a different company that then on-lent the amount to the loss company.

[74] Section IC 12(1).

[75] It is not necessary that the shares were issued directly to the write-off company.

101. For the purposes of the above rule, shares are treated as declining in value if:
   - there is a loss on the disposal of the shares; that is, the disposal amount is less than the deduction for the cost of the shares; and
   - where there has not been a disposal, the value of the shares declines, as calculated under subpart EB or otherwise.

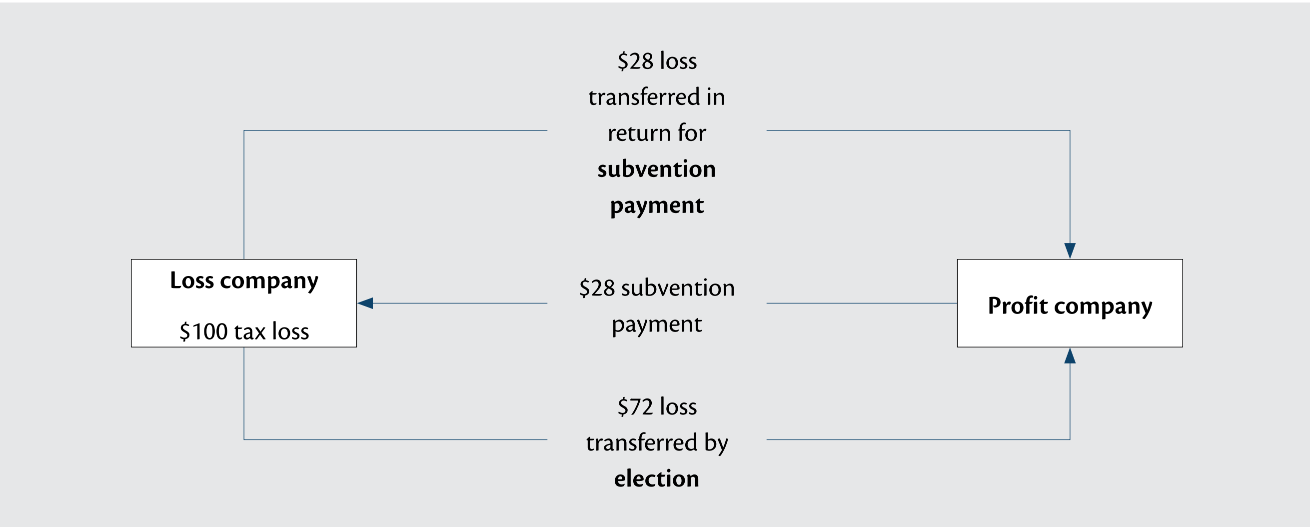
102. These rules limit sharing but do not prevent the loss company from carrying forward the tax loss component and applying the loss against its own net income for future tax years.

Two ways a loss can be shared

103. The two ways a tax loss can be shared are that the loss company can:[76]
   - make an **election** to share a tax loss with a profit company; and
   - transfer a tax loss to a profit company in return for a payment (referred to as a **subvention payment**) by the profit company to the loss company.

104. A combination of these methods can be taken in relation to a tax loss. For example, $100 of tax loss can be transferred $28 by subvention payment and $72 by election. This means the subvention payment can be lower than the total loss transferred. This is illustrated in Figure 4.

Figure 4 – Sharing a loss by election and subvention payment



105. A subvention payment may be desirable if the loss company has some shareholders who are not shareholders of the profit company (but commonality requirements are nevertheless met). The subvention payment can compensate the shareholders of the loss company for tax they may need to pay in the future because of the loss company's reduced loss balance. For this reason, it is common for 28 cents to be paid for each dollar of tax loss that is shared (this reflects the 28% company tax rate).

106. In the context of a subvention payment, "payment" has its normal meaning. It is considered that "payment" has a meaning corresponding to the definition of "pay" in s YA 1. "Pay" includes to distribute an amount to a person, credit an amount to a person or deal with the amount in the interest of, or on behalf of, a person. This means a profit company can, for example, make a payment to a loss company by acknowledging a debt to the loss company or by forgiving debt that the loss company owes it.[77]

107. A subvention payment cannot be more than the amount of the tax loss that the loss company shares with the profit company.[78]

108. A decision to share a loss, whether by election or subvention payment, must be notified to the Commissioner by the extended return date or by a later date if the Commissioner allows. See [70].

[76] Section IC 5(2).

[77] See also **"SPS 20/02: Loss offset elections between group companies"**, ***Tax Information Bulletin*** Vol 32, No 3 (April 2020): 18, at [8].

[78] Section IC 8(1) and (2).

Subvention payment is not a dividend

109. A loss company may be a shareholder of a profit company. In this case, a payment the profit company makes to the loss company could fall within the definition of "dividend" in s YA 1. However, the loss rules treat a subvention payment made by a profit company to a loss company (its shareholder) as not being a dividend.[79]

110. The protection from being a dividend can be lost if the Commissioner amends an assessment of one of the companies and this results in a decrease in the amount of tax loss that can be shared. See [252].

Decision to share a loss cannot be changed

111. If a loss company chooses to share a tax loss with a profit company, the loss company cannot later change its mind; the decision is irrevocable.[80] However, this rule does not prevent the Commissioner from making an amended assessment that reverses the sharing of the loss.[81]

112. Further, this rule does not prevent a loss company from making further loss elections (or receiving further subvention payments). For example, an amendment to a profit company's income tax return could result in the sharing of a tax loss being reversed. In such a situation, the loss company could make a further election to share that tax loss with a different profit company. The effect of amended assessments is discussed further at [243].

Loss company can also transfer imputation credits when sharing losses

113. Where a loss has been shared with a profit company, the Act also allows (where certain requirements are met) imputation credits to be transferred from the loss company (or another company in the same group of companies) to the profit company.[82] This makes up for the fact the loss offset will decrease the amount of tax paid by the profit company, which will result in the profit company generating fewer imputation credits from tax paid.[83]

Measurement of ownership rights

114. As discussed above, to:
    - carry forward losses, a continuity test (ownership or business continuity) must be met; and
    - share losses, a continuity test and the commonality test must be met.

115. Both the continuity and the commonality tests require a loss company to keep track of the ownership interests held in the loss company and (if sharing losses) the profit company. The ownership continuity test involves a 49% threshold, and the commonality test involves a 66% threshold.

116. A taxpayer may need to retain records for longer than is required for other purposes. For example, taxpayers are required to retain certain tax records for 7 years after the income year to which they relate.[84] The burden of proving that a tax loss component can be used is on the taxpayer. To satisfy this burden, a company may need to retain records for longer than 7 years.

117. The provisions considered in this part of the Interpretation Statement (that is, the provisions in subpart YC) are also relevant to other rules in the Act, including the imputation credit rules and associated person rules. However, the discussion in this statement focuses on the application of the provisions in subpart YC to the loss rules.

118. As discussed earlier, two types of ownership interest may be required to be tracked: voting interests and market value interests.

Voting interest

119. In a simple case, a person's voting interest in a company will be the same as the percentage of shares they own. This will be the case if there is only one type of share, no options over the shares, and the shares carry standard decision-making rights.

[79] Section IC 5(5).

[80] Section IC 5(4).

[81] *Westpac Securities NZ Ltd v CIR* [2014] NZHC 3377. See also "**SPS 20/03** Requests to amend assessments" (2 June 2020).

[82] Section OB 83.

[83] For more information, see, "Taxation (annual rates for 2016–17, closely held companies, and remedial matters) Act 2017 - **Loss grouping and imputation credits**", *Tax Information Bulletin* Vol 29, No 5 (June 2017): 30 at 110.

[84] Section 22 of the Tax Administration Act 1994.

120. In other cases, it is necessary to have closer regard to the definition of "voting interest" in s YA 1. Under the definition, a person's voting interest in a company is the percentage that represents shareholder decision-making rights carried by shares, or options over shares, held by the person—compared to the total shareholder decision-making rights for the company.

Shareholder decision-making rights

121. A shareholder decision-making right means a right to vote or participate in any decision-making concerning:
- a dividend or other distribution;
- the constitution of the company;
- a variation in the capital of the company; or
- the appointment of a director of the company.

122. It is possible for the percentage of shareholder decision-making rights carried by a share or option held by a person to differ as between the types of decision-making listed above. If this is the case, then the person's voting interest in the company equals the average (the total weighted average) of those differing percentages.

123. The calculation of this average gives equal weight (25%) to each of the four types of decision-making listed above. If a person has limited rights in relation to one of these types of decision-making, it will bring down the overall average accordingly.

124. Table 1 illustrates the calculation where a company is owned by two shareholders with equal rights, except in relation to the appointment of directors.

Table 1 - Calculation of shareholder decision making rights where proportion differs between types of decision-making rights

Type of decision-making right	Shareholder 1 (class A shares)	Weighted (25%)	Shareholder 2 (class B shares)	Weighted (25%)
Dividends	50%	12.5%	50%	12.5%
Constitution	50%	12.5%	50%	12.5%
Capital	50%	12.5%	50%	12.5%
Directors	100%	25%	0%	0%
Total weighted average		62.5%		37.5%

Protective rights under the Companies Act 1993

125. Sections 107 and 117 of Companies Act 1993 contain provisions that allow some participation in decision-making that could affect share rights. However, these rights are contingent and temporary in nature. The Commissioner considers that these sections do not give rise to shareholder decision-making rights for the purposes of the loss rules.

126. See **"IS 13/02: Income tax – whether certain protective rights conferred by the Companies Act 1993 are shareholder decision-making rights"**, *Tax Information Bulletin* Vol 25, No 10 (November 2013): 3.

Voting rights where shares are co-owned

127. If shares are co-owned by two or more people, a situation can arise under the Companies Act 1993 where one of the co-owners is treated as having the right to vote at shareholder meetings to the exclusion of other co-owners.[85] The Commissioner's view is that in these situations the voting co-owner will have at least some fiduciary obligations to the other co-owners in relation to the exercise of the voting interest.[86] Therefore, in the Commissioner's view, for the purposes of the loss rules, all the coowners will share the shareholder decision-making rights in relation to the share. In practice, the appropriate outcome can be achieved by treating the coowners as if they were a single person in relation to the ownership of the shares for the purposes of determining whether the continuity and commonality requirements are satisfied.

[85] The first co-owner listed on the share register is given the right to vote to the exclusion of other co-owners: s 124 and cl 11 of schedule 1 of the Companies Act 1993. This rule applies only where the company does not have a constitution that provides otherwise.

[86] Note that fiduciary duties do not generally arise from common ownership of property. However, the Court of Appeal in *Sew Hoy v Sew Hoy* [2001] 1 NZLR 391 accepted the proposition that fiduciary obligations may arise when an advantage is obtained by one co-owner utilising a right attaching to the property to the exclusion of others. The situation arising under the Companies Act 1993 for voting at meetings is a situation where one co-owner is given a right to the exclusion of other co-owners and, therefore, it is a case where at least some fiduciary obligations are likely to exist.

128. If one co-owner was treated as having shareholder decision-making rights and the other co-owner or owners were treated as not having shareholder decision-making rights, it could lead to anomalous results. For instance, depending on who was first listed on the share register for each company, a situation could arise where two companies that are both wholly and jointly owned by the same group of persons could be treated as having no commonality of ownership.

Further guidance on the timing of share transfers and who "holds" shares

129. For guidance on who "holds" shares and the nominee rule in s YB 21, see **"IS 12/01: Income tax – timing of share transfers for the purposes of the continuity provisions"**, *Tax Information Bulletin* Vol 24, No 7 (August 2012): 20.

Market value interest

130. As noted above, in most cases, it will be necessary to consider only voting interests. However, if there is a market value circumstance at any time during the continuity or commonality period, it is necessary to consider both voting and market value interests for the period.

131. The purpose of calculating market value interests is to accurately reflect the person's economic interest in the company in circumstances when voting interests do not do so.

132. Essentially, a person's market value interest in a company is the percentage that represents the market value of shares and options the person holds—compared with the total market value of such shares and options in the company.

133. There are a range of financial instruments that could fall within the meaning of a "share" or an option over a share. For example, a profit related debenture can be a "share".

134. The Act specifically defines "market value" for a share or option.[87] There are two definitions, depending on whether the share or option is listed on the official list of a recognised exchange:

- If the share or option is listed, market value means an amount equal to the "middle market quotation". This is essentially the average of the buy and sell prices quoted on the exchange at the close of the market (for example, on the NZX, it will be the average of the "high bid" and "low offer"). This method of determining the market value does not apply if the quotation is not a fair reflection of the market value having regard to certain factors listed in the Act.[88]
- If the share or option is not listed (or if the above definition cannot be used), market value means the amount a willing purchaser would pay to acquire the share or option in an arm's length acquisition, which is determined using a method that:
  - conforms with commercially acceptable practice;
  - may, in appropriate cases, have regard to the present value of the company's expected income or cash flows and the realisable value of the company's assets; and
  - results in a valuation that is fair and reasonable.

Market value circumstance

135. A market value circumstance[89] will exist if:

- a company has on issue:
  - a profit-related debenture;[90] or
  - a stapled debt security;[91] or
  - a share where:
    - a dividend is guaranteed or secured by a party other than the company; and
    - the directors of the company know or could reasonably be expected to know at the time that the payment of a dividend is so guaranteed or secured; and

[87] Section YA 1.

[88] See the factors listed in para (e) of the definition of "recognised exchange" in s YA 1.

[89] "Market value circumstance" is defined in s YA 1.

[90] Section FA 2. Without being exhaustive, this is essentially a debenture with a rate of interest that is set from time to time by reference to either the dividend payable by the company or the profits of the company.

[91] Section FA 2B. Without being exhaustive, this is essentially where a debt-security is stapled to a share. Stapled means that the debt security and the share can, or ordinarily can, be disposed of only together.

- the debenture, security or share is not:
  - an excluded fixed rate security;[92] or
  - a pre-1991 budget security.

136. A market value circumstance also exists where:

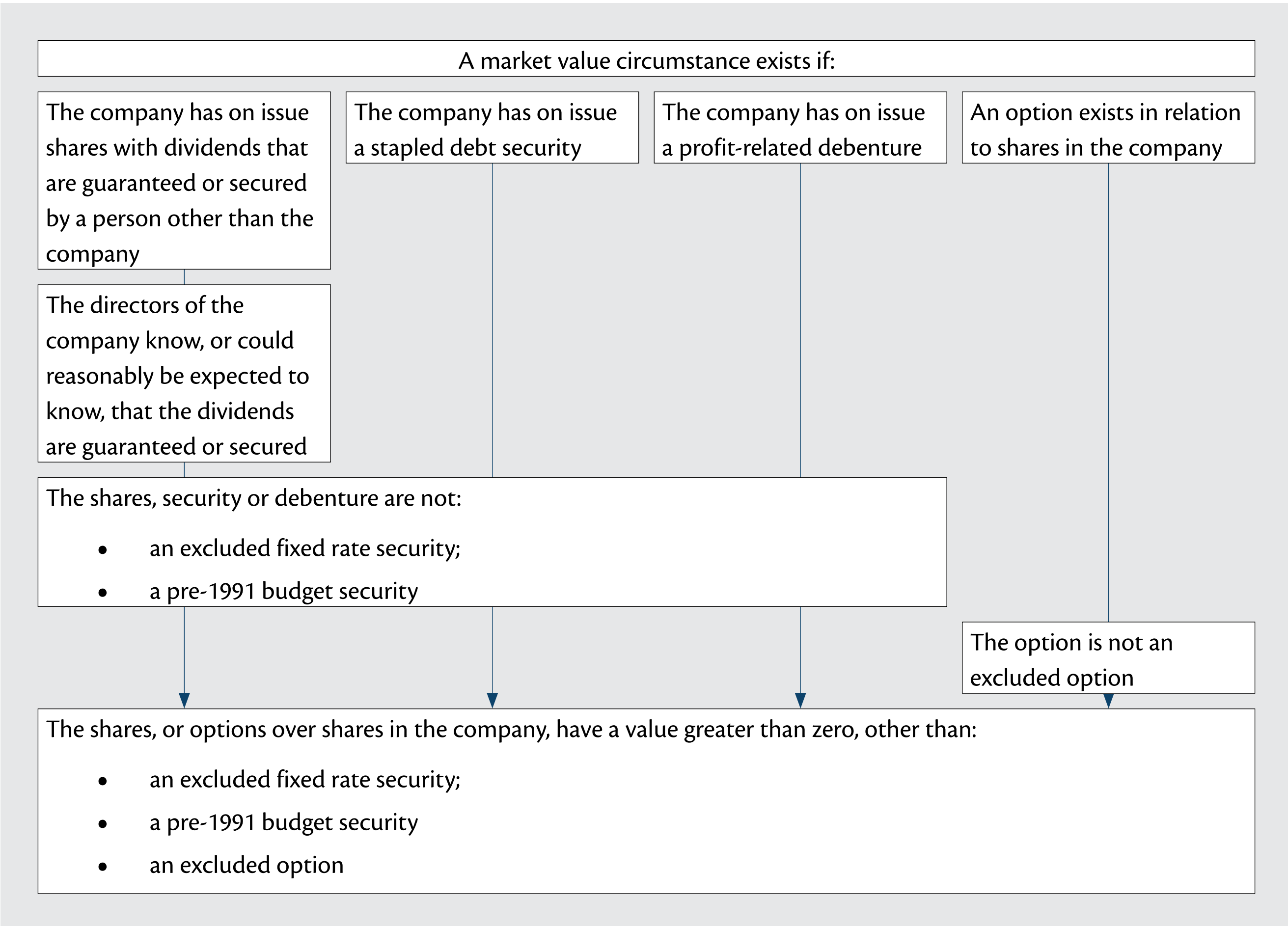
- an option exists that is:
  - to acquire a share in the company (that is, a call option) whether granted by the company or another person; or
  - to require a person to acquire a share in the company (that is, a put option); and
  - is not an excluded option.[93]

137. Despite the above, a market value circumstance will not exist if:

- none of the shares on issue have a value higher than zero, except for an excluded fixed rate security or a pre-1991 budget security; and
- no option has a value higher than zero, except for an excluded option.

138. The main ways that a market value circumstance can arise are summarised in Figure 5.

Figure 5 – Market value circumstance



139. The definition of market value circumstance also contains an anti-avoidance provision,[94] which, if it applies, treats a market value circumstance as existing.

140. The above types of market value circumstances are referred to as “direct market value circumstances”.

141. An example of a market value circumstance is provided in Example 5.

[92] “Excluded fixed rate security” is defined in s YA 1. Essentially, this is a fixed rate share or debenture that is a stapled debt security, not a profit-related debenture, and does not give the holder any right to vote or participate in any shareholder decision-making, except for certain protective rights.

[93] “Excluded option” is defined in s YA 1. The definition is discussed briefly at [127].

[94] Para (e) of the definition of “market value circumstance” in s YA 1.

Example 5 - Calculating voting and market interests at a point in time

Profit Co is wholly owned by Nadine and her voting interest is 100%. However, a market value circumstance exists for Profit Co because Profit Co has issued a profit-related debenture to Loy. Therefore, it is necessary to calculate the market value interests held by Nadine and Loy.

Nadine's shares in Profit Co have a market value of $500,000. This market value reflects the earning potential and the assets and liabilities (including the debenture) of Profit Co.

A profit-related debenture comes within the meaning of "share". Therefore, it is necessary to determine the market value of the debenture held by Loy, which is $175,000. This is the amount that a willing purchaser would pay to acquire the debenture in an arm's length acquisition (which is likely different from the amount repayable under the debenture).

The total market value of these financial instruments is $675,000. Therefore, Nadine's market value interest is 74% (500/675) and Loy's market value interest is 26% (175/675).

Determining the market value of a share that is subject to an option

142. As noted above, the purpose of calculating market value interests is to accurately reflect the person's economic interest in the company in circumstances when voting interests do not do so.

143. The loss rules take into account the market value of both shares and options. An option over a share can itself have a value to the holder and, at the same time, influence the value of the underlying share. This creates potential for the same economic interest in the company to be double counted, depending on how the market value of the share is calculated.

144. Therefore, the Act provides that if a share in a company is subject to an option, the market value of the share is calculated having regard to the terms of the option.[95] What this means could differ depending on the terms of the option. Further, discussion is beyond the scope of this Interpretation Statement.

145. The operation of this provision is illustrated in Example 6.

Example 6 – Market value of a share having regard to the terms of an option

Grant holds shares in a company. The shares are subject to an option also held by Grant. The option allows Grant to require the company to repurchase the shares in the company at $2 a share. In the absence of the option, the shares would have a market value of only $1.80 a share.

Grant's market value interest in the company includes the market value of the shares and the market value of the option. The option has a value of at least 20 cents per share.

Because the shares are subject to an option, the market value of the shares must be calculated having regard to the terms of the option. The purpose of having regard to the terms of the option is to avoid double counting. The relevant terms here include that this is a put option. If the value of the shares specified in the option was used, this would double count the value of the option. Therefore, in this case, the value of the shares in the absence of the option should be used, rather than the value specified in the option.

Therefore, for the purposes of the loss rules the market value of each share is $1.80.

Disregarding certain market value changes

146. A continuity or commonality requirement that has not been met is treated as being met if the:[96]

- requirement would have been met but for a change in the market value interest of one or more people; and
- change is attributable to:
  - a change in the market value of an asset (including an intangible asset) of the company;
  - a change in the market value of any one or more shares in the company that is not attributable to any change in the terms of those shares; or
  - a combination of the above.

147. This is illustrated in Example 7.

[95] Section YC 3(2).

[96] Section YC 16.

Example 7 - Disregarding a change in the market value of an asset

Loss Co is 100% owned by person A. At all times, person A has voting interests of 100%. Loss Co has a standard balance date.

Loss Co had a net loss for the 2022 income year that has not been used. It wishes to use this tax loss component to reduce its net income for the 2023 income year. Therefore, the continuity period for this tax loss component is the period from 1 April 2021 to 31 March 2023.

On 2 October 2021, a profit-related debenture (which is treated as a share under the Act) was issued to person B. The value of the debenture represents 50% of the total market value of shares in Loss Co.

In the 2023 income year, the value of Loss Co's intellectual property (**IP**) is re-valued, and this results in a decrease in the value of person A's ordinary shares in Loss Co. After the revaluation, person A's ordinary shares represent only 40% of the total market value of shares in Loss Co.

Because there is a market value circumstance (the issue of a profit-related debenture), it is necessary to consider voting interests and market value interests:

- The total of the lowest voting interest for the continuity period is 100% because person A at all times has voting interests of 100%.
- The total of the lowest market value interests for the continuity period is only 40%. This is the lowest market value interest held by person A in the period (the lowest market value interest held by person B is 0% because they began the period with 0% market value interests). See the following table.

This is illustrated in the following table:

	Continuity period begins: 1/04/2021	Issue of debenture 2/10/2021	Effect of IP Revaluation 31/03/2023	Continuity period ends: 31/03/2023	Lowest market value interest
Person A	100%	50%	40%	40%	40%
Person B	0%	50%	60%	60%	0%
Total					40%

In the absence of a rule disregarding changes in market value, the continuity requirement for carrying forward the 2022 net loss would not be met (40% is less than 49%). However, because the failure to meet the requirement is attributable to the change in the market value of Loss Co's IP, the continuity requirement is treated as being met under s YC 16.

Certain financial instruments are disregarded

148. A variety of financial instruments could carry shareholder decision-making rights (which could result in a voting interest) or fall within the meaning of a share or an option over a share (which could result in a market value interest). However, certain financial instruments are disregarded for continuity and commonality purposes, which means changes in the ownership of these instruments do not need to be tracked.[97] The instruments that are disregarded are:
    - an excluded fixed rate security[98] issued by a company;
    - an excluded option granted in relation to a company; and
    - a pre-1991 budget security[99] issued by a company.

149. These instruments are disregarded in the sense that they are treated as never having been issued or granted and as never having been held by the holder.

[97] Section YC 6.

[98] "Excluded fixed rate security" is defined in s YA 1. Essentially, this is a fixed rate share or debenture that is a stapled debt security, not a profit-related debenture and does not give the holder any right to vote or participate in any shareholder decision-making, except for certain protective rights.

[99] "Pre-1991 budget security" is defined in s YA 1.

Excluded option

150. The Act contains a detailed definition of "excluded option".[100] Briefly, it means an option to acquire or dispose of a share in the company in any of the following situations:

- The option is granted on arm's length terms and the option does not give the holder any right to vote or participate in any shareholder decision-making (with the usual exceptions to prevent alteration). A specific anti-avoidance rule can apply in this situation. This point is likely to exclude most options from consideration when determining voting or market value interests.
- The price payable to acquire the share on the exercise of the option is set by reference to the market value of the share on the date the option is exercised (or an amount that is not materially different), and the option does not give the holder any right to vote or participate in any shareholder decision-making (with the usual exceptions to prevent alteration).
- The directors of the company do not know and could not reasonably be expected to know that the option had been granted.
- The grantor of the option (or any person associated with the grantor of the option at the time the option is granted) did not hold a share in the company over which the option is granted at the time the option is granted, whether directly or indirectly. However, this point does not apply if the grantor of the option is the company.
- The share is an excluded fixed rate security, subject to s YC 20 in the case of the credit amount continuity provisions.
- Essentially, the option relates to a pre-1991 budget security that was granted before the specified time on 30 July 1991 and the terms of the option have not been altered since that time.

Death of share or option holder

151. If a person acquires a share or option on the death of a person (the **deceased person**) as a beneficiary or trustee under the will or intestacy, the person is treated as:

- having acquired the share or option on the date the deceased person acquired it; and
- having held it until the person in fact acquired it.

152. This treatment will preserve continuity of ownership in relation to the share or option, which could prevent a breach of continuity that might otherwise have occurred. This is illustrated in Example 8.

Example 8 – Death of shareholder

Loss Co has a $10,000 tax loss component that arose in the 2017 income year that has been carried forward.

Loss Co is 100% owned by person A. On 24 June 2022, person A dies and their shares in Loss Co are transferred to trustee X. Trustee X retains the shares for the duration of the Loss Co's 2023 income year ending 31 March 2023.

In the absence of any rule providing otherwise, this transfer on the death of person A would result in a continuity breach as the total of the lowest voting interests would be zero.

However, under s YC 8, trustee X is treated as having acquired the shares when they were acquired by person A (sometime before the 2017 income year).

	Voting interests as at 1/4/2016	Voting interests as at 24/6/2022	Voting interests as at 31/3/2023	Lowest voting interest
Person A	100%	0%	0%	0%
Trustee X	0%	100%	100%	0%
Total				0%
Section YC 8 treatment				
Trustee X	100%	100%	100%	100%

This preserves ownership continuity for Loss Co, meaning the 2017 tax loss component can be carried forward to the 2023 income year.

[100] In s YA 1.

153. The transfer of a share in a company on the death of a person could still result in a change in the commonality of ownership of the company and another company in a group going forward. For this reason, where a deceased person had shares or options in two or more companies in a group of companies, and an executor plans to transfer the shares to beneficiaries, the proportions in which the shares in the companies are transferred to beneficiaries may affect whether commonality is preserved.

Transfer of share or option on settlement of relationship property

154. Similar treatment applies to a person who acquires a share or option on a settlement of relationship property. In this case, the recipient of the property is treated as:[101]

- having acquired the share or option on the date it was acquired by the transferor; and
- having held it until the person in fact acquired it.

Shares or options held by trustees

155. For continuity and commonality purposes, all the trustees of a trust that hold (in their capacity as trustees of the trust) a share or option in a company are treated as a notional single person. The notional single person is treated as:

- not being a company (even if the trustees include corporate trustees); and
- separate and distinct from any other capacities that the trustees may have (for example, their personal capacities or their capacities as trustees of other trusts).[102]

156. This treatment means if there is a change in the ownership of shares resulting from a change in the trustees of the trust, the change in ownership will have no effect on continuity or commonality of ownership.

157. This treatment also means ownership interests are not attributed beyond the notional single person; that is, to the beneficiaries of the trust. Attribution under the look-through ownership attribution rules is discussed from [181].

158. The treatment of shares or options held by trustees is illustrated in Example 9.

159. This treatment is subject to anti-avoidance rules.[103]

Example 9 – Shares or options held by trustees

Loss Co is 100% owned person A as the sole trustee of trust Z. Person A retires as trustee and is replaced by person B. As a result of the change in trustee, the shares in Loss Co are transferred from person A to person B.

The transfer of the shares has no effect on continuity or commonality of ownership because the shares are at all times treated as being held by a notional single person; they are never treated as being held by person A or person B.

Special corporate entities (including incorporated societies)

160. The treatment of shares or options held by special corporate entities is similar to the treatment of shares or options held by trustees. However, unlike trustees of a trust, a special corporate entity may be able to share a tax loss.[104]

161. A "special corporate entity" includes public and local authorities, incorporated societies, and other specified entities that typically do not issue shares to shareholders.

162. However, for tax purposes a special corporate entity is treated as having issued shares. The shareholders[105] are treated as holding the shares and related rights (including any indirect interests attributed under the look-through rule) as a notional single person (similar to the trustees of a trust).

163. The notional single person treatment will ensure that ownership continuity is always maintained allowing a special corporate entity to carry forward losses.

[101] Section FB 10.

[102] Section YC 9.

[103] See s YC 9(2) to (4) and s GB 5.

[104] Trustees of a trust cannot share a tax loss because a trust is not a company (also a corporate trustee is treated as not being a company for these purposes).

[105] The shares are treated as held by members, for the time being, of the entity (or by directors if there are no members or, in the case of a public authority or state enterprise that does not have members or directors, by the Minister of the Crown).

164. Losses can be shared between a special corporate entity and companies owned by the special corporate entity, provided that commonality and other requirements for sharing are met. However, losses cannot be shared between a special corporate entity and its members.

Shareholders holding direct ownership interests of less than 10%

165. For continuity and commonality purposes, ownership interests of less than 10% in a subject company (a loss or profit company) are treated as held by a notional single person.[106] This allows smaller ownership interests to be tracked together as a group.

166. This rule applies where:

- a person has a direct ownership interest in a subject company of less than 10%; and
- the person is not a company that is associated with the subject company.

167. Note that this rule applies to **direct** ownership interests; that is, it is applied before the look-through ownership attribution rules (discussed from [181]) are applied.

168. Because the ownership interests of less than 10% are treated as being held by the notional single person and not the direct owner, this rule also has the effect of preventing these ownership interests from being attributed to indirect owners under the look-through ownership attribution rules.

169. The application of this rule is illustrated in Example 10.

170. The ownership interests treated as held by the notional single person may contribute to a company maintaining its continuity of ownership during a commonality period. However, despite the application of this rule, the requirements of a continuity or commonality provision can be treated as not being met in the situation described at [175].

Example 10 – Shareholders holding direct ownership interests of less than 10%

Loss Co has a $10,000 tax loss component arising from the 2019 tax year that hasn't been used yet. It wishes to use this loss for the 2023 tax year. Loss Co has a standard balance date.

During the continuity period for this tax loss component (1 April 2018 to 31 March 2023) there are two shareholding changes:

- On 23 June 2019, shareholder 1 sells all their shares (with voting rights of 45%) to shareholder 5.
- On 17 October 2021, shareholder 4 sells all their shares (with voting rights of 7.5%) to shareholder 6.

The effect of these changes is illustrated in the following table.

Shareholders	**Voting interests at different times during the continuity period**				**Lowest voting interest**
	1/4/2018	23/6/2019	17/10/2021	31/3/2023	
Shareholder 1	45%	**0%**	0%	0%	0%
Shareholder 2	40%	40%	40%	40%	40%
Shareholder 5	0%	**45%**	45%	45%	0%
Notional single person					
Shareholder 3	7.5%	7.5%	7.5%	7.5%	
Shareholder 4	7.5%	7.5%	**0%**	0%	
Shareholder 6	0%	0%	**7.5%**	7.5%	
Notional single person	15%	15%	15%	15%	15%
Total	**100%**	**100%**	**100%**	**100%**	**55%**

[106] Section YC 10.

Shareholders 3, 4, and 6 satisfy the requirements of s YC 10 for their voting interests to be treated as held by the notional single person:

- their direct voting interests are less than 10%, and
- they are not companies that are associated with Loss Co (that is, none of the associated person tests in s YB 2 are satisfied between them and Loss Co).

In this case, the sale of shares by shareholder 4 to shareholder 6 had no effect on the level of voting interests that are treated as held by the notional single person.

The combination of the 40% lowest voting interest for shareholder 2 and the 15% lowest voting interests treated as held by the notional single person is sufficient to maintain continuity during the continuity period.

Therefore, Loss Co can carry the $10,000 loss forward to the 2023 tax year.

171. If a person's direct ownership interest increases to 10% or more, the notional single person rule will no longer apply to their interest. In the absence of any relief, this could result in a change of ownership that could impact on continuity and commonality requirements. However, relief is provided by the rule to ensure concessionary treatment described below. This rule would allow the company to account for the ownership interest of the person from the beginning of the continuity or commonality period for the purposes of carrying forward or sharing a tax loss component.

Rule to ensure concessionary treatment

172. The rule applying to direct ownership interests of less than 10% is intended to be concessionary for taxpayers. However, in some cases, the application of this concessionary rule can result in continuity or commonality requirements **not** being met.[107]

173. The Act responds to this issue by treating continuity or commonality requirements as being met for a company at a particular time if:

- the continuity or commonality requirements are not met at the time, but
- would have been met but for the application to a particular extent of the concessionary rule.[108]

174. This is illustrated in Example 11.

Example 11 – Breach caused by a person's ownership interest increasing to 10% or more

Same facts as in Example 10, except that on 31 March 2023 shareholder 3 acquires 5% of the shares in the company held by shareholder 5.

This takes shareholder 3's ownership interest from 7.5% to 12.5%. This is outside the coverage of the concessionary rule applying to direct ownership interests of less than 10%.

As illustrated in the following table, in the absence of any relief, this change in shareholding would result in a breach of the continuity requirement for Loss Co. Despite there only being a 5% change in ownership, the total lowest voting interest would decrease by 7.5% down to 47.5%, which is below the 49% threshold.

[107] See Example 11. Another example is that the treatment under s YC 10 can prevent look-through of small ownership interests to other owners that might have contributed to a relevant threshold being met.

[108] Section YC 14.

Shareholders	Voting interests at different times during the continuity period				Lowest voting interest
	1/4/2018	23/6/2019	17/10/2021	31/3/2023	
Shareholder 1	45%	0%	0%	0%	0%
Shareholder 2	40%	40%	40%	40%	40%
Shareholder 3	0%	0%	0%	**12.5%**	0%
Shareholder 5	0%	45%	45%	**40%**	0%
Notional single person					
Shareholder 3	7.5%	7.5%	7.5%	-	
Shareholder 4	7.5%	7.5%	0%	0%	
Shareholder 6	0%	0%	7.5%	7.5%	
Notional single person	15%	15%	15%	7.5%	**7.5%**
Total	100%	100%	100%	100%	47.5%

However, the Act provides relief if the continuity requirement would have been met but for the application of the concessionary rule.

The following table shows the ownership interests in Loss Co if the concessionary rule had not been applied to the ownership interests of shareholder 3 from the beginning of the continuity period.

Shareholders	Voting interests at different times during the continuity period				Lowest voting interest
	1/04/2018	23/06/2019	17/10/2021	31/03/2023	
Shareholder 1	45%	0%	0%	0%	0%
Shareholder 2	40%	40%	40%	40%	40%
Shareholder 3	7.5%	7.5%	7.5%	**12.5%**	7.5%
Shareholder 5	0%	45%	45%	**40%**	0%
Notional single person					
Shareholder 4	7.5%	7.5%	0%	0%	
Shareholder 6	0%	0%	7.5%	7.5%	
Notional single person	7.5%	7.5%	7.5%	7.5%	7.5%
Total	100%	100%	100%	100%	55%

The table shows that the total of the lowest voting interests would be 55%, which is above the 49% threshold. This means that the continuity requirement would have been met but for the application of the concessionary rule. As a result, the Act will treat the continuity requirement as being met.

Therefore, Loss Co can still carry the $10,000 loss forward to the 2023 tax year.

Anti-avoidance provision

175. Despite the application of the concessionary rule applying to direct ownership interests of less than 10%, an anti-avoidance provision may apply to treat the continuity or commonality requirements as not being met.[109]

176. In determining whether the anti-avoidance provision applies, a company can disregard share and option transactions of a certain type.[110] These include certain on-market and off-market transfers between shareholders or between shareholders and the company.

[109] Section YC 15.

[110] Listed in s YC 15(1)(b).

177. If there are other share transactions that cannot be disregarded, it is necessary to consider whether those transactions would, but for the application of the concessionary rules, have resulted in the breach of a continuity or commonality requirement. If they would, then it is necessary to apply a director knowledge test.[111] Under this test, it is necessary to determine whether the directors of the company knew, or could reasonably have been expected to know without making enquiries specifically for the purposes of applying the continuity provisions, that the transactions (that is, the transactions that cannot be disregarded) would result in the breach of the continuity or commonality requirement. If the director knowledge test is satisfied, then the anti-avoidance provision will treat the continuity or commonality requirement as not being met.

178. The knowledge requirement may be more easily satisfied for companies with few shareholders and whose directors are more involved in the tracing of shareholder changes.

Special rules

179. Special rules apply:

- for a company that is a "special corporate entity" as defined in s YA 1;[112]
- where an insurer stops being a special corporate entity because of demutualisation;[113]
- to the Crown's investment in a mixed ownership enterprise;[114]
- to reverse takeovers[115] and corporate reorganisations that, economically, would not result in an ownership change that would breach continuity;[116]
- to the legislative conversion of a foreign company of proprietors;[117] and
- to the termination of trusts for the sole benefit of the New Zealand government or an overseas government.[118]

180. These special rules are outside the scope of this Interpretation Statement.

Look-through ownership attribution rules

181. Generally, the look-through ownership attribution rules attribute ownership interests in a subject company[119] up any chain of ownership to the ultimate owners of the subject company (although in some cases, as discussed at [189], attribution will stop before reaching the ultimate owner). Generally, the ultimate owners are treated as having ownership interests, and the intermediate owners[120] are treated as not having those interests.[121]

182. An ultimate owner may have ownership interests in a subject company through more than one chain of ownership (including through a direct ownership interest). Where this is the case, the ownership interests are aggregated to find the ultimate owner's ownership interest.[122]

183. The look-through mechanism operates by treating a person with an ownership interest in an intermediate company as having a portion of the intermediate company's (direct or indirect) ownership interest in the subject company. This portion is calculated by multiplying the person's ownership interest in the intermediate company with the intermediate company's (direct or indirect) interest in the subject company.[123] This attribution can occur multiple times before the interest is attributed to the ultimate owner (or attribution otherwise stops). The attribution calculation is illustrated in Example 12 (based on voting interests) for one of the ultimate owners of a subject company. The attribution calculation needs to be performed for all the ultimate owners unless a look-through exception applies.

[111] Section YC 15(1)(c).

[112] Section YC 5. The definition of special corporate entity includes, among other entities, public and local authorities, and other specified entities that typically do not issue shares to shareholders.

[113] Section YC 17.

[114] Defined in s YC 5B and listed in part B of sch 36. There were four mixed ownership enterprises as of 2 May 2022: Air New Zealand Ltd, Genesis Energy Ltd, Meridian Energy Ltd, and Mighty River Power Ltd (now Mercury NZ Ltd).

[115] Section YC 18.

[116] Section YC 18B.

[117] Section YC 19.

[118] Section YC 19B.

[119] This statement uses the term "subject company". Note s YC 4 refers to this company as the "issuing company".

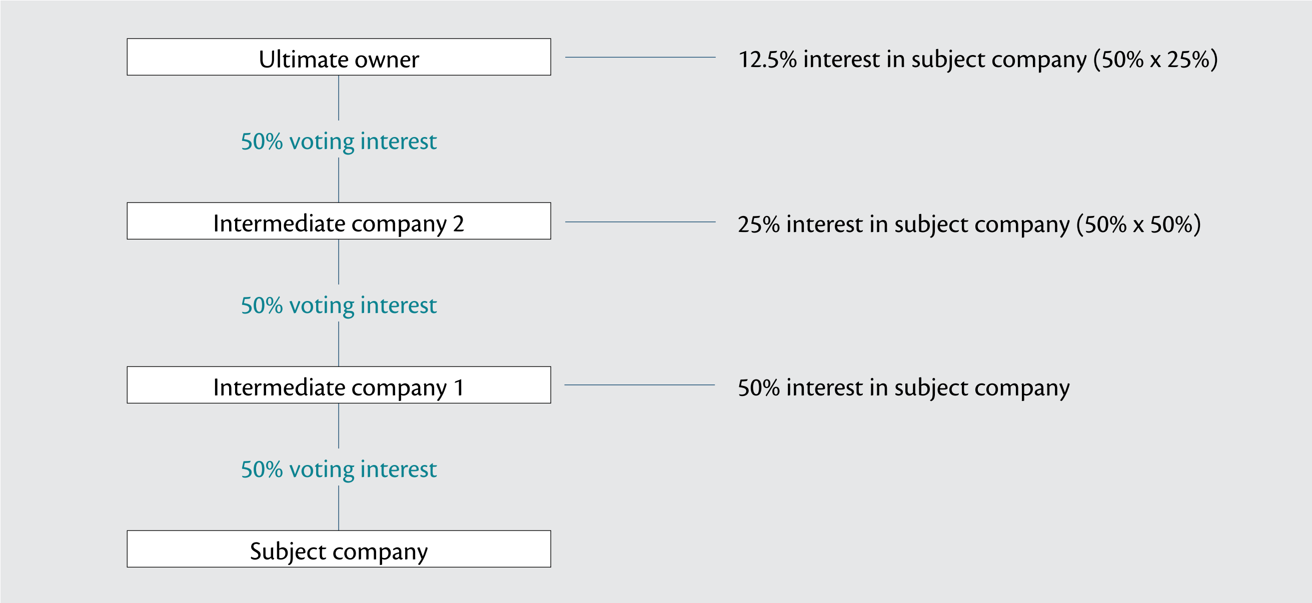
[120] This statement uses the term "intermediate owner". Note s YC 4 refers to this company as the "shareholder company".

[121] This is provided for in s YC 4(2) (for voting interests) and (5) (for market value interests).

[122] Section YC 4(2) and (5).

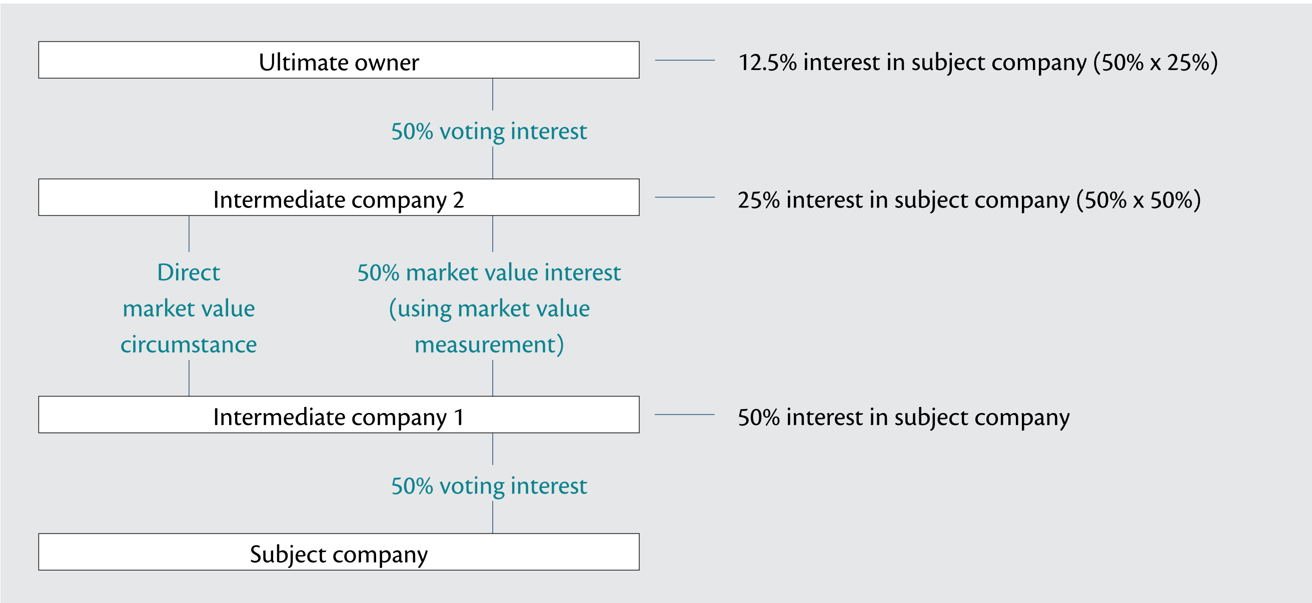
[123] Section YC 4(3) and (6).

Example 12 – Attribution calculation for one ultimate owner



184. Where a company in a chain of ownership has a market value circumstance, it will also be necessary to calculate the market value interests held in that company (that is, using the market value calculation). For other companies in the chain of ownership that do not have a market value circumstance, voting interests in those companies are used to calculate indirect market value interests in the subject company and to attribute market value interests to the ultimate owners.[124] This is illustrated in Example 13 with respect to one of the ultimate owners.

Example 13 - Look-through – market value interests



185. In Example 13, a direct market value circumstance exists in relation to intermediate company 1 (for example, because intermediate company 2 holds a non-market option over shares in intermediate company 1).

186. Because of this, intermediate company 2 must calculate its market value interest in intermediate company 1. The market value interest in intermediate company 1 is then used to calculate intermediate company 2's indirect market value interest in the subject company. To do this, intermediate company 2 must multiply its market value interest in intermediate company 1 by intermediate company 1's voting interest in the subject company. This gives intermediate company 2 a 25% market value interest in the subject company.

[124] Section YC 4(8).

187. It is also necessary for intermediate company 2's 25% market value interest in the subject company to be attributed to the ultimate owner. This is attributed based on the ultimate owner's voting interest in intermediate company 2. This is calculated by multiplying the ultimate owner's 50% voting interest in intermediate company 2 by intermediate company 2's 25% market value interest in the subject company.

188. This gives the ultimate owner a 12.5% market value interest in the subject company from this chain of ownership. This interest is added together with any other interest that the ultimate owner has in the subject company through other chains of ownership. For example, if the ultimate owner also has direct voting rights of 10% in the subject company, then overall it would have a market value interest of 22.5% (12.5% + 10%).

Look-through may stop with an intermediate company in a chain of ownership

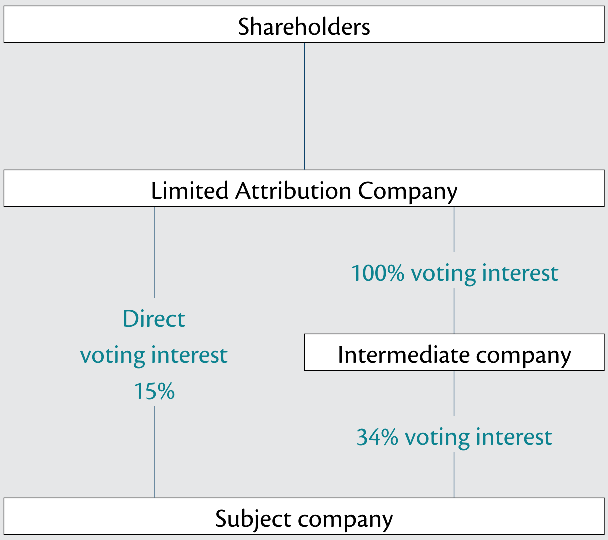
189. Generally, the look-through rule will continue to attribute interests in a subject company until the interest is attributed to a natural person (or to a notional single person as in the case of shares held by trustees). However, in the following cases, attribution will stop with an intermediate company in a chain of ownership. This is to reduce compliance costs associated with attribution.

Attribution stopping at limited attribution company

190. Attribution will stop with a limited attribution company if the company's (direct and indirect) ownership interests in the subject company total less than 50%.[125] This is illustrated in Example 14.

191. "Limited attribution company" is defined in s YA 1 as a company that is a building society, registered co-operative company, listed company, widely-held company, or foreign company that is not a closely-held company.

Example 14 – Attribution stopping at limited attribution company



Attribution stops at the limited attribution company because the direct (15%) and indirect (34% (100% x 34%)) voting interests total 49%, being less than 50%

Attribution stopping with intermediate company if the amount that would be attributed is less than 10%

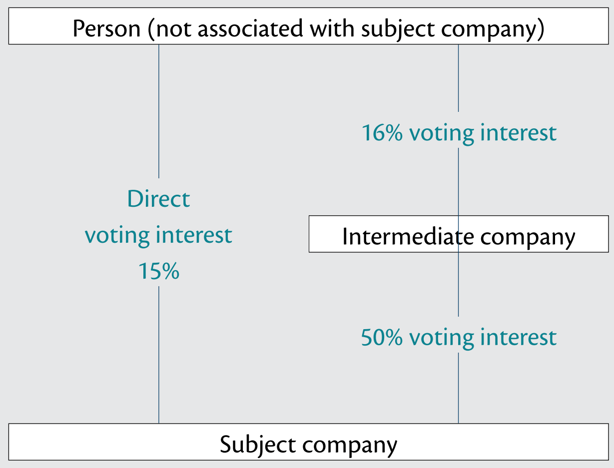
192. The attribution of a portion of ownership interests in a subject company will stop with an intermediate company if the:[126]

- portion that would otherwise be attributed by the intermediate company to a person is less than 10%; and
- person is not associated with the subject company.

193. This is illustrated in Example 15.

[125] Section YC 11(2).
[126] Section YC 11(3).

Example 15 – Attribution stopping with intermediate company if amount that would be attributed is less than 10%



Attribution stops at the intermediate company because the portion that would be attributed from the intermediate company is less than 10% (50% x 16% = 8%). The person's other voting interest of 15% is not relevant to this attribution rule.

Variation to attribution intended to be concessionary

194. The above variations to the general look-through rule are intended to be concessionary. If continuity or commonality requirements would have been met but for the application of these variations, then the continuity or commonality requirements are treated as being met.[127] This is subject to the same condition as described at [174].

Special look-through rules for certain types of entity

195. Special look-through rules apply in relation to certain types of entity and situations, including rules relating to:

- public unit trusts;[128] and
- corporate spin-outs.[129]

196. These special rules are outside the scope of this Interpretation Statement.

Part-year rules

Introduction

197. Under the general loss rules, for a tax loss component to be used for a tax year, the loss company must meet the continuity requirement:

- from the start of the period in which the tax loss component arose;
- until the end of the income year corresponding to the tax year in which the loss is sought to be used.

198. Similarly, for a tax loss to be shared, commonality must also be satisfied for this period.

199. The part-year rules[130] recognise that part way through an income year there could be an event (for example, a change in the shareholding of a loss company) that results in continuity or commonality being breached[131] or established[132] for a tax loss component and a group of persons.

200. In the absence of the part-year rules, if a continuity or commonality event occurred part way through the income year, this could prevent a tax loss component from being used or shared for the corresponding tax year or from being carried forward.

[127] Section YC 14.
[128] Section YC 12.
[129] ection YC 13.
[130] The part-year rules are in subpart IP.
[131] For tax loss components in the income year and in previous income years.
[132] Generally, for part of the net loss for the tax year.

201. In these cases, the part-year rules ensure certain losses can still be used in the relevant part-year periods. This is consistent with the purpose of the loss rules (to ensure that, largely, losses are available to be used by the people who ultimately incurred the losses[133]) and avoids an outcome that would otherwise follow from the assessment of income tax on an annualised basis.

202. There are also part-year rules that cater for breaches of the business continuity rules. However, these are outside of the scope of this Interpretation Statement. See the Interpretation Statement **IS 22/06** "Loss carry-forward – continuity of business activities".

Summary of what the part-year rules do

203. Where there is a continuity breach for a tax loss component from an earlier income year, under the part-year rules the component can still be used to reduce the pre-breach net income of the loss company. Then, if commonality is satisfied, the tax loss component from the earlier income year can be used to reduce the pre-breach net income of a profit company.[134]

204. Similarly, if there is a tax loss component (for example, a net loss) for the pre-breach part of the income year,[135] the amount could, if commonality were satisfied during that part-year period, be shared and used to satisfy the pre-breach net income of a profit company.[136]

205. Following a breach of continuity, the part year rules allow a loss company to carry forward a net loss for the post-breach period.

206. The part-year rules also cater for the possibility that commonality is established part-way through the income year between a loss company and a profit company. In this case, where the commonality is maintained for the part-year period, the part year rules allow sharing of the net loss incurred in the part-year period.[137]

Carrying forward losses under the part-year rules

207. There are two carry forward scenarios to consider for a loss company:

- Where there has been a breach of continuity in an income year for a tax loss component from a previous income year, the tax loss component can potentially be **carried forward to the breach income year**.[138] This is sometimes referred to as a loss that is "brought forward".
- Where there is a breach of continuity that would affect a net loss for a tax year, a post-breach net loss can be **carried forward to the subsequent tax year**.

Carrying forward to the breach income year

208. If there has been a breach of continuity in an income year for a tax loss component that arose in a previous income year, it may still be possible for at least part of the tax loss component to be carried forward to the pre-breach part of the income year.

209. The tax loss component can be carried forward to the extent that the loss company can use or share the loss in the pre-breach period. Any excess amount cannot be carried forward to the income year and will not be available in subsequent income years.

210. The loss company can use the tax loss component to reduce the loss company's net income for the pre-breach part of the income year.[139] The loss company will need to provide adequate financial statements to support its calculation of the net income in this part-year period.

[133] To the extent that the business continuity rules do not apply.

[134] This is also limited to the full year net income if that is lower (ss IP 4(2)(ab) and (4) and IC 8). The full year net income might be lower if income and expenses fluctuate for the profit company during the income year.

[135] The part-year rules are not restricted to net loss tax loss components, but this will be the main type. Other types of tax loss component such as CFC and FIF losses are outside the scope of this statement. For simplicity, in the year of breach, the rest of this part of the statement will simply refer to net losses.

[136] This is also limited to the full year net income if that is lower (ss IP 4(2)(ab) and (4) and IC 8). The full year net income might be lower if income and expenses fluctuate for the profit company during the income year.

[137] As noted above, CFC and FIF losses are outside the scope of this statement but note that the part-year rules do not apply to the sharing of these types of loss. See s IQ 4(2)(d).

[138] Remember that continuity is tested for each tax loss component. Different tax loss components may have different continuity periods and, therefore, be affected by different share transactions during those periods, for example.

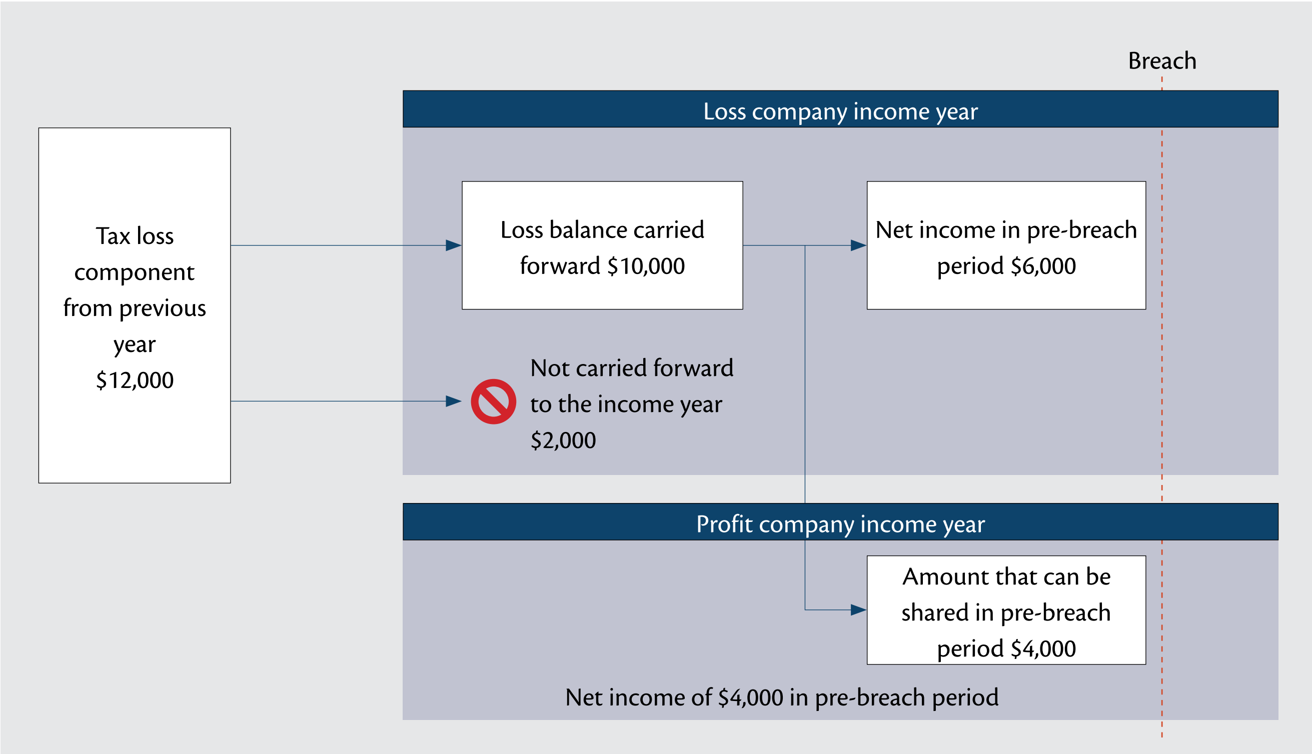
[139] The loss company does not need to have net income for the tax year as a whole. For example, the loss company could have a net loss for the tax year as a whole, with net income in the pre-breach period and a larger net loss in the post-breach period.

211. This is illustrated in Figure 6 below. In Figure 6, a total of $10,000 can be carried forward to the income year because that is how much loss can be used in the pre-breach period ($6,000 can be used to reduce the loss company's net income in the pre-breach period and $4,000 can be shared in the pre-breach period as the profit company has net income in the period of $4,000). In the company income tax return (form IR4), $10,000 is entered as the "net losses brought forward" amount.[140] The remaining $2,000 of the tax loss component from the previous year cannot be carried forward to the income year and will not be available in subsequent income years.

212. Carrying forward a loss to a breach income year is also illustrated in Example 16 and Example 17.

213. Sharing losses under the part-year rules is discussed below from [219].

Figure 6 – Tax loss component from a previous income year carried forward to breach income year



Example 16 - Carrying forward to the income year

Loss Co made a $100,000 net loss in the 2021 income year. This is Loss Co's only tax loss component. In the 2022 income year Loss Co had net income of $150,000. Loss Co has always had a standard balance date.

Shares in Loss Co were sold on 5 October 2021 (during the 2022 income year), which resulted in an ownership continuity breach for the 2021 net loss amount.

Loss Co prepares part-year financial accounts that show net income of $82,000 for the period from 1 April 2021 to 5 October 2021.

Loss Co can use $82,000 of the 2021 net loss to reduce its net income in the pre-breach period to zero.

Loss Co also identifies from part year accounts that it can share $10,000 of the 2021 net loss with another company under the part-year loss rules (discussed from [219]).

Therefore, in total, Loss Co can carry forward $92,000 ($82,000 +$10,000) of the 2021 net loss to the pre-breach period for the above uses. Loss Co therefore enters $92,000 as the "net losses brought forward" in field 28A of the 2022 company income tax return (form IR4). The remaining $8,000 of the 2021 net loss cannot be carried forward and will no longer be available.

[140] In the 2022 version of the IR4, this was field 28A.

Example 17 – Part-year net income, full year net loss

Loss Co made a $15,000 net loss in the 2013 income year, which it has been able to carry forward over the years. Loss Co has always had a standard balance date.

On 31 October 2022, shares in Loss Co are sold. This share sale results in ownership continuity for the 2013 net loss falling below the 49% continuity threshold.

In the 2023 income year, in the part-year period before the continuity breach, Loss Co had **net income** of $10,000. In the part-year period after the breach, Loss Co had a **net loss** of $50,000.

Loss Co can carry forward $10,000 of the 2013 net loss to the 2023 income year to reduce the $10,000 pre-breach net income.

The remaining $5,000 of net loss from 2013 cannot be carried forward and will no longer be available.

Carrying forward a post-breach net loss

214. Where a breach of continuity would affect a net loss arising in the income year of the breach, a net loss amount can still potentially be carried forward to the subsequent income year.[141] This net loss amount is the lowest of:[142]

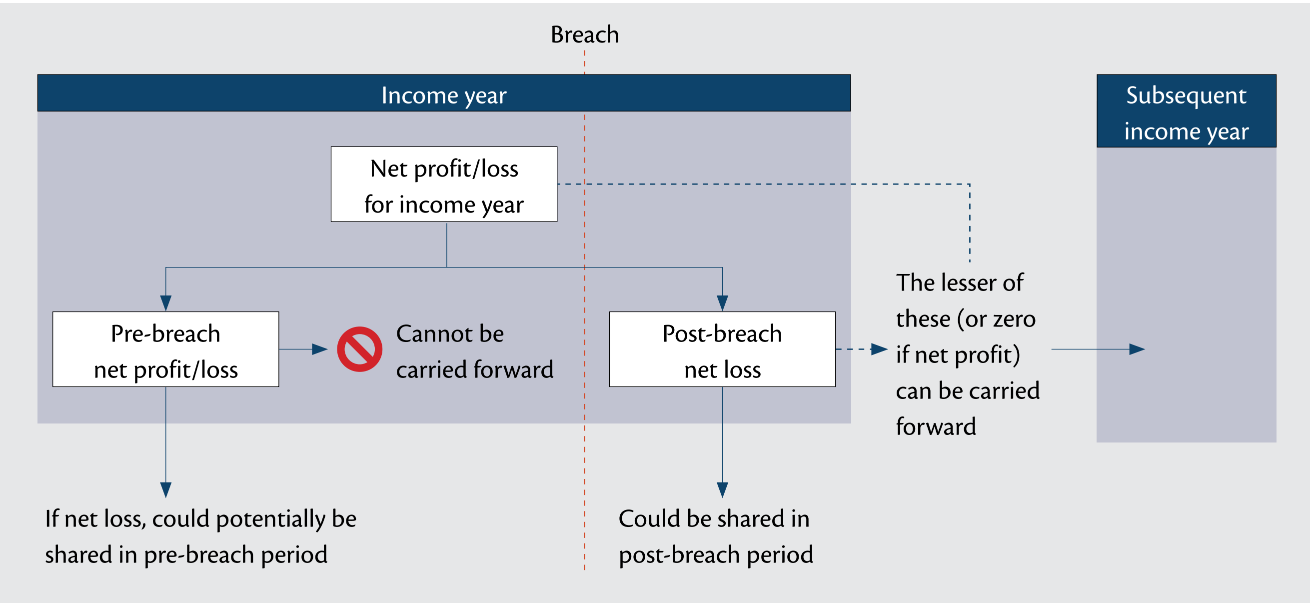
- the net loss for the post-breach period;
- the net loss for the income year as a whole (the net loss for the income year as a whole may be lower if, for example, the company's profitability varies during the year); or
- zero, if the loss company has net income for the income year as a whole.

215. This is illustrated in Figure 7 and Example 18.

216. To carry forward a post-breach net loss from the tax year, the loss company would need to provide adequate financial statements to support the calculation of the post-breach amount.

217. Alternatively, the post-breach amount could be shared. Sharing losses under the part-year rules is discussed from [219].

Figure 7 – Carrying forward a post-breach net loss



[141] Section IP 3(4).
[142] Section IP 3(5).

Example 18 - Carrying forward a post-breach net loss

On 23 November 2022 (during the 2023 income year), Loss Co's majority shareholder sold his 80% share in the company. Loss Co has always had a standard balance date.

Based on part-year financial accounts, in the pre-breach period from 1 April 2022 to 22 November 2022, Loss Co had net income of $10,000. In the post-breach period from 23 November to 31 March 2023, Loss Co had a net loss of $30,000. Therefore, for the whole income year, Loss Co had a net loss of $20,000.

The change in shareholding on 23 November 2022 results in an ownership continuity breach with respect to the net loss for the 2023 income year.

Despite the breach, the part-year rules allow Loss Co to carry forward $20,000 of net loss (the amount carried forward is limited to the full year net loss as this is lower than the post-breach amount).

Pre-breach tax loss components not shared are not available going forward

218. If a loss company has a pre-breach tax loss component (for example, a net loss), this could be shared with a profit company and used by the profit company to reduce net income for a part-year period (see from [219]).[143] If the tax loss component cannot be shared, it will not be available going forward. This is illustrated in Figure 7.

Sharing losses under the part-year rules

Introduction

219. The part-year rules on sharing allow the following:
   - A tax loss component from a previous income year may be shared with a profit company, to the extent that it is used to reduce the profit company's net income for a period before the breach, referred to in the legislation as a **common span** (discussed below at [226]).
   - The net loss for the pre-breach period in the income year may be shared with a profit company; again, to the extent that it is used to reduce the profit company's net income for the common span.
   - Part of a net loss for an income year may be shared where a group of persons establishes commonality between a loss company and a profit company part way through an income year. The net loss for the period after commonality is established can be shared and used by the profit company to reduce the profit company's net income for a corresponding period, which is also referred to as a common span.

Notification and adequate financial statements are required

220. To use the part-year sharing rules, the loss company must notify the Commissioner of the part-year treatment of the tax loss.[144] The loss company must give this notification by its extended return date or by a later date allowed by the Commissioner (this is the same notification timeframe that applies for sharing losses generally, see [68]).

221. The loss and profit companies must also provide adequate financial statements that calculate the part-year net loss and net income amounts, as discussed from [238].

Sharing can be limited by the profit company's full-year net income

222. Under the general sharing rules, the amount of a tax loss that a loss company can share with a profit company is limited by the net income of the profit company.[145]

223. In the part-year rules, the amount that can be shared is limited by the lower of the net income of the profit company:
   - that is allocated to the part-year period (common span); or
   - for the whole tax year.

224. The net income for the whole tax year might be lower due to seasonal differences in the profitability of a company's business, for example.

225. The amount that can be shared is not limited by the whole-year net loss of the loss company (where that is lower than the net loss calculated for the part-year period).

[143] The loss company might also have tax loss components from previous income years that it can share in the pre-breach period.

[144] Under s IP 7.

[145] Remember that a profit company's "net income" is modified for this purpose. See [45].

Sharing can be limited by the common span

226. The common span is a period that defines the:

- losses in the breach year that can be shared; and
- net income of the profit company that can be reduced by the losses.

227. Where there is a breach of continuity or commonality, there will be a pre-breach common span. This will be relevant to a tax loss component from a previous income year and to any net loss for the part-year period leading up to the breach.

228. There will also be a post-establishment common span where continuity or commonality is established part way through the income year. This will be relevant to the net loss for the part-year period following the breach or establishment of continuity or commonality.

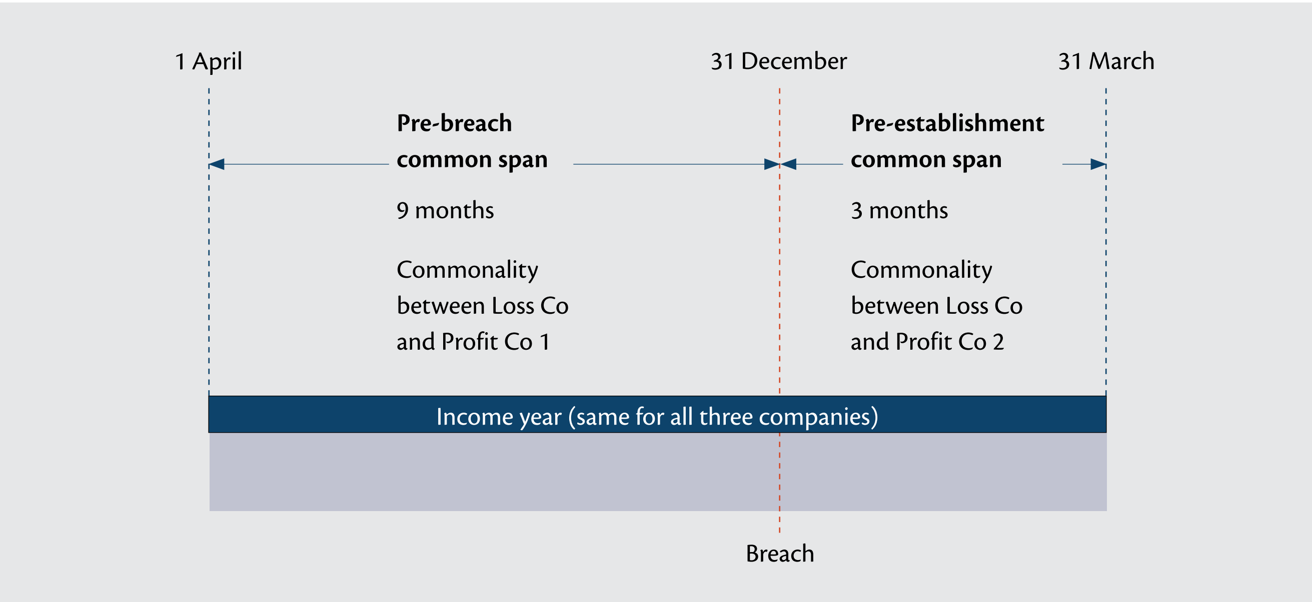
229. Loss sharing in a pre-breach common span and a post-establishment common span is illustrated in Example 19.

Part-year sharing where the loss and profit company have the same balance date

230. If the loss company and the profit company have the same balance date, the common span is the corresponding part of the loss company's income year and the profit company's income year, during which the commonality and continuity requirements are met.

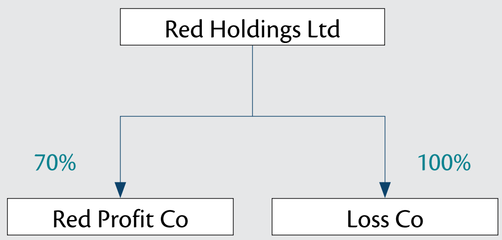
231. See Figure 8, which assumes that commonality exists between Loss Co and Profit Co 1 until a shareholding change at which point the commonality is breached. However, after the shareholding change, commonality is established between Loss Co and Profit Co 2.

Figure 8 – Common spans – loss and profit companies with the same balance dates

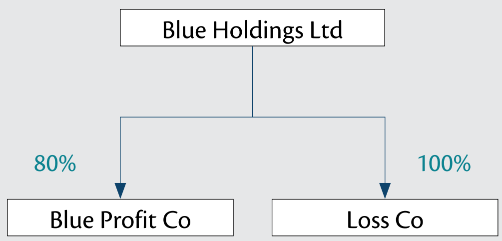


Example 19 - Application of part-year rules

Initially, Loss Co is 100% owned by Red Holdings Ltd. Red Holdings also owns 70% of the shares in Red Profit Co. The initial shareholding of Loss Co is shown below:



On 31 December 2022 (in the 2023 income year), Red Holdings Ltd sells all its shares in Loss Co to Blue Holdings Ltd. Blue Holdings Ltd also owns 80% of the shares in a company called Blue Profit Co. The new shareholding of Loss Co is:



This sale of shares breaches Loss Co's continuity for all its tax loss components. It also breaches commonality between Loss Co and Red Profit Co for all the tax loss components but establishes commonality with Blue Profit Co in relation to part of the net loss for the 2023 income year.

Loss Co, Red Profit Co and Blue Profit Co all have standard 31 March balance dates.

Loss Co has $500,000 of tax loss components from previous income years and a $100,000 net loss for the 2023 income year. Financial statements prepared for Loss Co show that $75,000 of the net loss arose in the pre-breach common span (1 April to 31 December) and $25,000 in the post-establishment common span (1 January to 31 March).

Financial statements prepared for Red Profit Co show that it had net income of $400,000 for the pre-breach common span. Financial statements prepared for Blue Profit Co show that it had net income of $30,000 in the post-establishment common span, but net income of only $20,000 for the 2023 income year as a whole.

Pre-breach common span

Loss Co can share $400,000 of tax loss components from previous income years with Red Profit Co in the pre-breach common span. This is the amount that is entered as the "net losses brought forward" in the company income tax return (form IR4). The other $100,000 of tax loss components from previous income years cannot be brought forward and will no longer be available.

Further, the $75,000 net loss from the pre-breach common span cannot be used as Red Profit Co does not have any more income in the pre-breach common span.

Post-establishment common span

Loss Co can share $20,000 of the $25,000 net loss from the post-establishment common span with Blue Profit Co. This is capped at the amount of Blue Profit Co's net income for the income year, which is lower than the net income for the common span.

Carried forward to next tax year

Loss Co can carry forward the remaining $5,000 of net loss from the post-establishment common span to the next tax year.

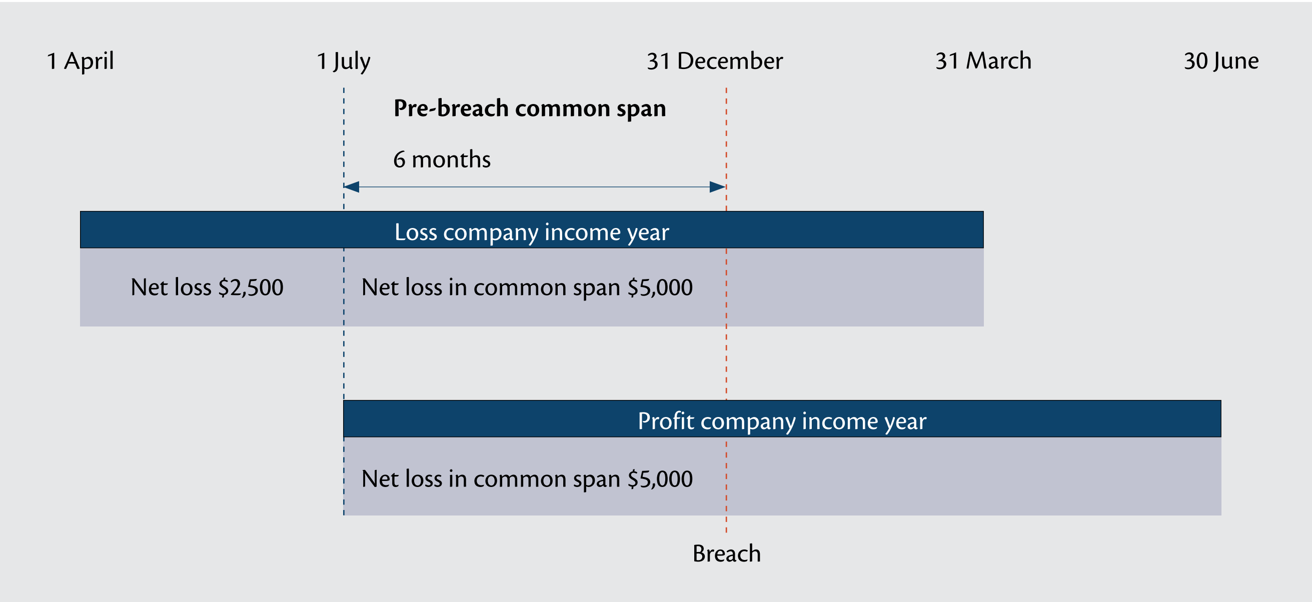
Part-year sharing where loss and profit company do not have the same balance date

232. If the loss company and the profit company do not have the same balance date, then the common span is the part of the **profit company's** income year during which the commonality and continuity requirements are met. This is illustrated in the following figures.

233. The following figures also illustrate some of the limitations on part-year sharing that are caused by differing balance dates. These scenarios assume that the requirements for sharing, including the provision of adequate financial statements, are met.

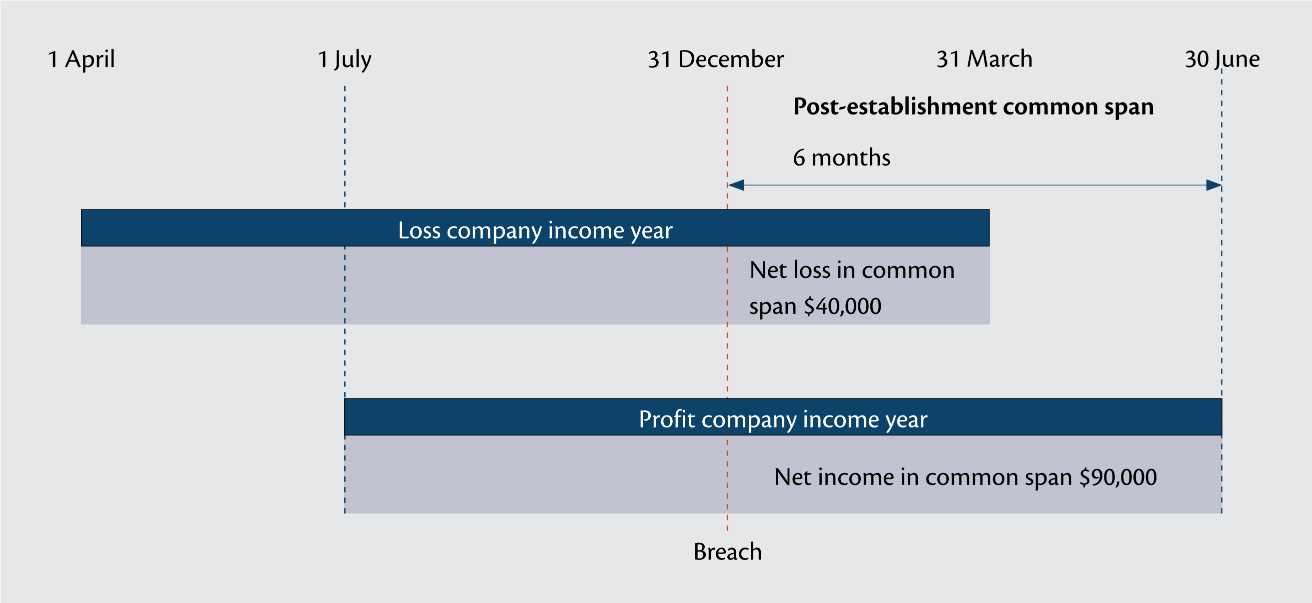
234. In Figure 9, $5,000 of the loss company's net loss can be shared and off-set against the profit company's pre-breach net income of $5,000. The $2,500 of net loss cannot be shared.

Figure 9 – Pre-breach common span where profit company has a later balance date



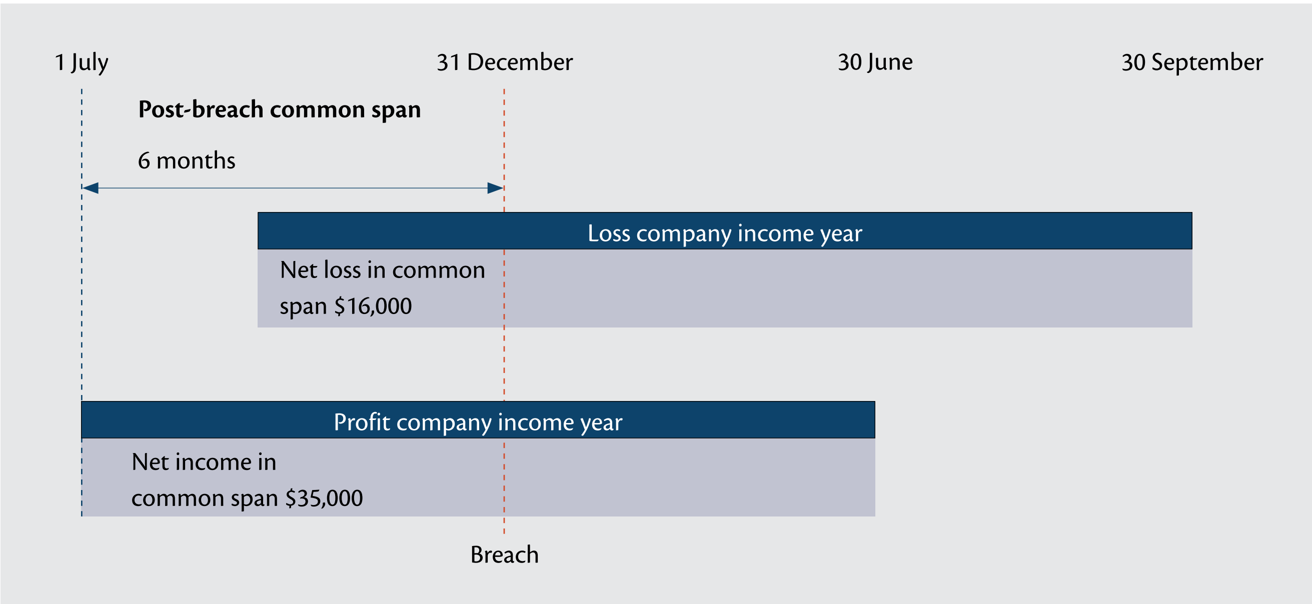
235. In Figure 10, the $40,000 of net loss can be used to reduce the profit company's net income from the post-establishment common span.

Figure 10 – Post-establishment common span where profit company has later balance date



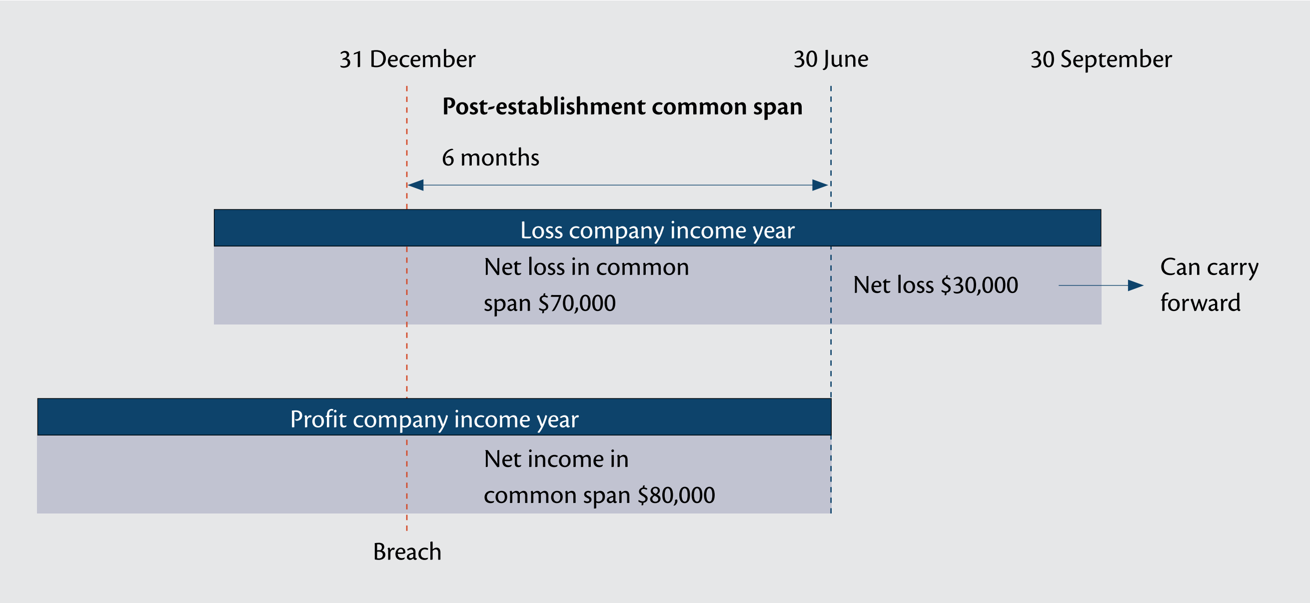
236. In Figure 11, in the pre-breach common span, the loss company's pre-breach tax loss of $16,000 can be offset against the profit company's $35,000 pre-breach net income.

Figure 11 – Pre-breach common span where profit company has an earlier balance date



237. In Figure 12, $70,000 of the loss company's $100,000 post-breach net loss can be offset against the profit company's $80,000 post-breach net income. The remaining $30,000 of net loss can be carried forward to the following tax year.

Figure 12 – Post-establishment common span where profit company has an earlier balance date



Adequate financial statements

238. For the part-year rules to apply, the loss and profit companies must provide adequate financial statements to support the allocation of the net loss and net income to the part-year periods.

239. Adequate financial statements are required for a loss company to:

- carry forward losses from an earlier year to the tax year to reduce its pre-breach net income;[146] the loss company must provide statements to support the pre-breach net income amount;
- carry forward a post-breach net loss for a tax year to the subsequent tax year;[147] the loss company must provide statements to support the post breach net loss amount;
- share a pre- or post-breach net loss with a profit company;[148] the loss company and the profit company must provide statements to support the loss company's net loss and the profit company's net income amounts in the relevant common span periods, as relevant; and
- share losses carried forward to the tax year with a profit company in the pre-breach period;[149] the profit company must provide statements to support its net income in the pre-breach common span.

240. The financial statements need to calculate net loss and net income amounts (as relevant) for the appropriate common span periods. It is important to remember that where a loss company and the profit company do not have the same balance date, the common span is defined by the profit company's income year and the breach date. For a loss company, it is not necessarily sufficient to merely determine the pre- or post-breach net income amounts (see Figure 9 and Figure 12).

241. The net loss and net income amounts must be determined on a fair and reasonable basis of attribution. This will generally require an attribution based on the timing of the income derived and the deductible expenditure incurred during the income year.

242. For practical guidance on preparing these financial statements, see **"SPS 20/02: Loss offset elections between group companies"**, *Tax Information Bulletin* Vol 32, No 3 (April 2020): 18 at [26] to [28].

[146] Under s IP 3(2).
[147] Under (s IP 3(4).
[148] Under s IP 4(2).
[149] Under s IP 5(2).

Amended assessments

243. The Commissioner may amend an assessment of a loss company or a profit company.[150] Amendments to the income or deductible expenditure of a company can lead to consequential loss adjustments[151] for the company in assessments for subsequent income years, or in the assessments of other companies. Many different scenarios can arise because:

- the amended assessments could result in tax loss or net income being increased or decreased;
- sharing losses depends on both the level of the loss company's tax loss and the profit company's net income;
- the loss company may or may not have used or shared all its tax loss for a tax year;
- reduced tax losses may need to be reallocated among multiple profit companies; and
- where a tax loss has been transferred by subvention payment and the tax loss is reduced, the subvention payment may be treated as a dividend.[152]

244. Amended assessments are discussed in SPS 20/02.

245. The following sections discuss two scenarios and particular rules that apply in those scenarios: consequential adjustments where net losses have been shared with multiple profit companies and the effect of decreased tax losses on subvention payments.

Consequential adjustments where net losses have been shared with multiple profit companies

246. If after a reduction to a tax loss component, a loss company's adjusted tax loss for a tax year is still higher than the amount that has been shared with profit companies for that tax year, then no further action is required by the profit companies.

247. However, if the adjusted tax loss for a tax year is lower than the amount that was shared, the amount by which the profit companies reduced their net income using the tax loss will require adjustment.[153]

248. Subject to one exception, the loss company can choose how the adjustment is allocated between the profit companies. The exception is that a loss company cannot allocate more than a proportionate amount of the adjustment to a profit company that, at the time of the allocation, is no longer a member of the group of companies. If the loss company does, the allocation will be disregarded.

249. The loss company must notify the Commissioner of the allocation within a notification period. This notification period is:

- six months after the date on which the Commissioner notifies the loss company that the adjustment is required; or
- a longer period agreed by the Commissioner.

250. If the loss company does not make an allocation, then the tax loss amounts shared with the profit companies are decreased in the same proportion as the loss company's tax loss has decreased (referred to as a **proportionate reduction**).

251. This is illustrated in Example 20.

[150] Under s 113 of the Tax Administration Act 1994 (the **TAA**). Amendments to underlying assessments, for example, changes to income or allowable deductions, are generally subject to the disputes process. If an amendment is not agreed and other exceptions do not apply, the Commissioner is required to propose the amendment in a notice of proposed adjustment and follow the disputes process to determine whether to make the assessment.

[151] Consequential adjustments to losses are not subject to the disputes process. See s 89C(d), (g) and (k) of the TAA. These assessments simply reflect the underlying assessment of income and deductions for example, which will either have been agreed or made because of a direction from the Taxation Review Authority or a court.

[152] This can be avoided if the subvention payment is repaid.

[153] Section IC 11.

Example 20 – Adjustment to tax loss shared with profit companies

Loss Co filed its return for the 2020 tax year claiming a net loss of $100,000. This was Loss Co's only tax loss component.

Loss Co shared $75,000 of the $100,000 net loss equally with three profit companies in the same group of companies. Each profit company reduced its net income for the 2020 tax year by $25,000.

Following an audit of the 2020 return in 2022, an amended assessment was proposed with a reduced net loss of $50,000. At the same time, the Commissioner notified Loss Co that the total amount of tax loss shared with the profit companies is greater than the adjusted tax loss proposed. Therefore, consequential adjustments are also proposed to the amount shared with the profit companies.

Loss Co agrees to the Commissioner's proposed adjustment and does not make any allocation of the amount by which the tax loss shared exceeds the adjusted tax loss. Therefore, the profit companies make a proportionate reduction as follows:

Loss Co			
	Original	**Adjusted**	**Adjustment**
Tax loss	$100,000	$50,000	$50,000
Tax loss shared	$75,000	$37,500	$37,500
Tax loss remaining	$25,000	$12,500	$12,500
Profit companies (Reduction in net income)			
	Original	**Adjusted**	**Adjustment**
Profit Co 1	$25,000	$12,500	$12,500
Profit Co 2	$25,000	$12,500	$12,500
Profit Co 3	$25,000	$12,500	$12,500
Total	$75,000	$37,500	$37,500

Note the proportionate reduction does not result in all $50,000 of the adjusted net loss being shared. A loss balance of $12,500 remains with Loss Co.

Variation – Loss Co instead allocates the adjusted tax loss

This variation has the same facts as above, except Loss Co chooses how to allocate the loss adjustment between the profit companies and notifies the Commissioner of the allocation within six months of the Commissioner's loss adjustment notification:

Loss Co			
	Original	**Adjusted**	**Adjustment**
Tax loss	$100,000	$50,000	$50,000
Tax loss shared	$75,000	$50,000	$25,000
Tax loss remaining	$25,000	$0	$25,000
Profit companies (Reduction in net income)			
	Original	**Adjusted**	**Adjustment**
Profit Co 1	$25,000	$25,000	$0
Profit Co 2	$25,000	$12,500	$12,500
Profit Co 3	$25,000	$12,500	$12,500
Total	$75,000	$50,000	$25,000

In this variation, Loss Co has fully allocated the $25,000 decrease in the tax loss between Profit Co 2 and Profit Co 3 and has shared all the adjusted tax loss leaving itself with a zero loss balance.

Effect of decreased tax losses on subvention payments

252. As discussed above, where a profit company pays a loss company a subvention payment for a loss, the subvention payment is treated as not being a dividend for the loss company (the payment could be a dividend if the loss company is a shareholder of the profit company). This protection from being a dividend applies only to the extent to which a tax loss is subtracted from the profit company's net income.[154]

253. Therefore, if an amendment is made and, consequently, less tax loss can be shared with the profit company, a subvention payment received by a loss company could be treated as a dividend.

254. However, if a subvention payment received by a loss company is treated as a dividend, the dividend is reduced to the extent that the subvention payment is repaid by the loss company within a notification period.[155] The notification period is:[156]

- six months after the date on which the Commissioner notifies the loss company that an adjustment is required to the tax loss shared with the profit company; or
- a longer period agreed by the Commissioner.

255. This is illustrated in Example 21.

[154] Section IC 5(5).

[155] The repayment can be made in any of the ways a subvention payment could be made. Payment has a meaning corresponding to "pay" in s YA 1.

[156] Section IC 11(6).

Example 21 - Effect of decreased tax loss on subvention payment

Loss Co filed its return for the 2020 tax year on 31 March 2021 claiming a net loss of $100,000. This was Loss Co's only tax loss component.

Loss Co shared the full $100,000 of net loss with Profit Co. In return, Profit Co made a subvention payment to Loss Co of $28,000. In other words, the $100,000 net loss was shared $72,000 by election and $28,000 by subvention payment. The subvention payment was made on 31 March 2021, the same day Loss Co filed its return. Profit Co used the loss to reduce its net income by $100,000.

Loss Co and Profit Co both have standard balance dates.

Loss Co is a shareholder in Profit Co. Section IC 5 applied to prevent the $28,000 payment from Profit Co to Loss Co from being a dividend.

However, on 1 September 2022, as a result of an audit of the 2020 return, the Commissioner proposed to amend Loss Co's assessment with a reduced net loss of $20,000.

On the same date, the Commissioner pointed out to Loss Co that the $100,000 net loss shared with Profit Co is greater than the $20,000 adjusted net loss proposed by the Commissioner.

Loss Co agreed to the Commissioner's proposed adjustment.

As a result, a consequential adjustment was also made to Profit Co's assessment on the basis that the net loss shared by Loss Co with Profit Co is only $20,000 rather than $100,000. This results in Profit Co having an additional $80,000 of net income.

Further, on 5 February 2023, within six months of the Commissioner's notification, Loss Co chose to repay $22,400 of the $28,000 subvention payment that it received from Profit Co (this reduced the subvention payment to $5,600, which is 28% of $20,000). As a result, the adjusted subvention payment is not more than the total loss shared with Profit Co and, therefore, no part of the subvention payment received by Loss Co is treated as a dividend. If Loss Co had not repaid any of the subvention payment it would have had dividend income of $8,000 in the 2021 tax year (the amount by which the original subvention payment exceeded the total loss shared).

Reporting obligations

Return requires information about minimum ownership interests

256. The company income tax return requires a loss company to enter the total lowest economic interests of shareholders during the income year.[157]

257. Note that the "total lowest economic interests" is an annual measurement that is required under the return to help keep track of ownership changes in the income year. This is relevant for determining how a net loss for the income year can be used. However, when determining whether ownership continuity or commonality has been maintained for a tax loss component from an earlier income year, it is necessary to have regard to ownership changes over the entire continuity or commonality period, which could span multiple years.

When a non-active company can be excused from filing returns

258. Sometimes a loss company will be non-active, and the question arises as to whether it needs to file an income tax return.

259. Unless the Commissioner requires otherwise,[158] a company is not required to provide a return of income for an income year if the company:[159]

- was a non-active company throughout the income year;
- has provided a completed non-active company declaration (IR433) to the Commissioner; and
- has been a non-active company at all times since making the declaration.

157 In the 2022 version of the IR4, this was question 41.

158 Under s 43A(7) of the TAA.

159 Under s 43A(1) of the TAA.

260. A company is non-active for an income year if throughout the income year, the company:[160]

- has not derived any income (other than interest derived on a bank account that does not exceed bank charges and other minimal administration costs totalling no more than $50);
- has no deductions (other than statutory company filing fees, associated accounting or other costs, or bank or other minimal administration costs totalling no more than $50;
- has not disposed of, or been deemed to dispose of, any asset;
- has not been party to or continued with any transactions that, during the income year give rise to:
  - income for any person;
  - fringe benefits to any employee or to any former employee; or
  - a debit in the company's imputation credit account.

261. Keep a record of the company's loss and imputation account balances before the company is excused from filing as this information will be needed if the company is reactivated.

Reactivation

262. If a non-active company that was excused from filing ceases to be non-active, the company must:[161]

- notify the Commissioner;
- provide the Commissioner with a completed non-active company reactivation form (IR434), which must include:
  - the company's loss balance before it was excused from filing;
  - the company's imputation credit account balance before it was excused from filing;
  - the company's ownership before it was excused from filing;
  - whether the shareholding ownership of the company (direct or indirect) has changes since it was excused from filing and the details of those changes; and
  - whether the change in ownership would prevent it using any loss or credit balances.

References

Case references

CIR v Alcan NZ Ltd [1994] 3 NZLR 439 (CA).

Sew Hoy v Sew Hoy [2001] 1 NZLR 391 (CA).

Westpac Securities NZ Ltd v CIR [2014] NZHC 3377.

Legislative References

Income Tax Act 2007

Sections BC 4, BC 5, BC 7, subpart EB, ss FA 2, FA 2B, GB 3, GB 3BA, GB 3BAB, GB 3BAC, GB 3B, GB 4, GB 5, part I (subparts IA, IB, IC, IP), ss IQ 4, IW 1, IZ 7, IZ 8, LE 2, OB 83, YA 1 ("available tax loss", "company", "dividend", "excluded fixed rate security", "excluded option", "limited attribution company", "market value", "market value circumstance", "pay", "pre-1991 budget security", "recognised exchange", "special corporate entity", "voting interest"), YB 21, subpart YC, schedule 36 (part B)

Other

Companies Act 1993: ss 107, 117, 124, sch 11 (cl 11)

Financial Reporting Act 2013

Tax Administration (Financial Statements) Order 2014

Tax Administration Act 1994: ss 43A, 89C, 113

[160] Section 43A(2) and (3) of the TAA.

[161] Section 43A(6) of the TAA.

Other references

"IS 22/06 "Loss carry-forward – continuity of business activities", Interpretation Statement. **https://www.taxtechnical.ird.govt.nz/interpretation-statements/2022/is-22-06**

"COVID-19 Response (Taxation and Other Regulatory Urgent Measures) Act 2020", *Tax Information Bulletin* Vol 32, No 7 (August 2020): 4. **www.taxtechnical.ird.govt.nz/tib/volume-32---2020/tib-vol32-no7**

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"IS 13/02: Income tax – whether certain protective rights conferred by the Companies Act 1993 are shareholder decision-making rights", *Tax Information Bulletin* Vol 25, No 10 (November 2013): 3. **www.taxtechnical.ird.govt.nz/tib/volume-25---2013/tib-vol25-no10**

"IS 12/01: Income tax – timing of share transfers for the purposes of the continuity provisions", *Tax Information Bulletin* Vol 24, No 7 (August 2012): 20. **www.taxtechnical.ird.govt.nz/tib/volume-24---2012/tib-vol24-no7**

Payment of Shortfall Penalty Using Losses (SPS 16/04, Wellington, Inland Revenue, October 2016). **www.taxtechnical.ird.govt.nz/en/standard-practice-statements/shortfall-penalties/sps-1604-payment-of-shortfall-penalty-using-losses**.

QUESTIONS WE'VE BEEN ASKED

This section of the *TIB* sets out the answers to some day-to-day questions people have asked. They are published here as they may be of general interest to readers.

QB 22/08: Goods and Services Tax – Payments made by parents to private schools

This Question We've Been Asked explains the GST treatment of payments parents make to private schools.

Another QWBA on donation tax credits and a parent's payment to their child's private school (**QB 22/09**) and a public ruling on payments by parents to state schools and state integrated schools (**BR Pub 18/06**) can be found on our Tax Technical website.

Question

When will a parent's payment to their child's private school be subject to GST?

Answer

In most cases, a parent's payment to their child's private school will be subject to GST.

Private schools make taxable supplies of education and education-related goods and services to parents. Usually, schools will charge GST on these supplies at the standard rate of 15%.

However, there can be exceptions, in particular:

- an "unconditional gift" a parent makes to their child's private school is not subject to GST; and
- some of the boarding fees a parent pays to their child's private school can be subject to GST at what is, in effect, a reduced rate of 9%.

Key term

Parent also includes a child's guardian or caregiver who makes payments to a private school.

Private school means a school registered under s 214 of the Education and Training Act 2020. This Question We've Been Asked (QWBA) assumes all private schools are GST registered. It also assumes most private schools are non-profit bodies for GST purposes.

Explanation

1. The Commissioner has been asked to clarify the GST treatment of payments parents make to private schools. (**QB 22/09: Income Tax – Payments made by parents to private schools and donation tax credits**[1] clarifies when payments parents make to private schools will be gifts for donation tax credit purposes.)
2. This QWBA complements earlier GST advice published for parents with children attending state schools and state integrated schools (**BR Pub 18/06**).
3. In addition, in the past, there have been situations where parents have made "donations" to private schools in substitution for paying no or low school fees. The Commissioner's view on this practice was addressed in **Revenue Alert 14/01**. Payments made by parents to private schools incorrectly described as "donations" are not unconditional gifts for GST purposes.
4. Private schools have also asked for some guidance on the GST treatment of boarding fees charged for students staying in a school boarding house, and when the reduced GST rate for the supply of "domestic goods and services" will apply.
5. This QWBA assumes that private schools are registered for GST.

[1] Inland Revenue, 2022.

Scheme of the Goods and Services Tax Act 1985

6. Generally, a private school charges GST on the goods and services it supplies in the course or furtherance of its taxable activity at the standard rate of 15% (see s 8). A private school's taxable activity is the provision of education and education-related goods and services to students and their families.
7. Usually, the value of a private school's supplies is determined by reference to the "consideration" paid for those supplies (see s 10(2)). "Consideration", as defined in s 2, includes payments made in respect of the supply of goods and services.
8. However, for private schools there can be two exceptions to this general rule. This is where:
   - a parent's payment is an "unconditional gift" (as defined in s 2) and so is not "consideration", and therefore is not subject to GST; or
   - a private school makes a supply of "domestic goods or services" (as defined in s 2) to a parent as part of the school supplying boarding accommodation for a student. Generally, for stays in a school boarding house that will be longer than four weeks, the value of the supply of "domestic goods and services" is reduced to 60% of the consideration paid for GST purposes. This effectively reduces the rate of GST the school charges for that portion of the boarding fees from 15% to 9%.
9. Both these exceptions are addressed in more detail below.

Unconditional gifts

10. If a private school that is a non-profit body receives a payment from a parent that is an "unconditional gift", that payment is not subject to GST.
11. For detailed guidance on GST and unconditional gifts, see "**IS 20/09** GST – unconditional gifts".[2]

Non-profit body

12. This QWBA assumes that most private schools are non-profit bodies for GST purposes, although it recognises some private schools are not. Essentially, a private school will be a non-profit body for GST purposes (see s 2) if the school is:
    - carried on other than for the purposes of profit or gain to any proprietor, member or shareholder; and
    - prohibited from making distributions to any of those people.
13. If the school's governing documents do not provide this, then the school cannot be a non-profit body for GST purposes. If a school is a registered charity, it will be a non-profit body for GST purposes. However, registration under the Charities Act 2005 is not a requirement for being a non-profit body for GST purposes.

Unconditional gift

14. A payment made to a non-profit body is an "unconditional gift" where:
    - the payment is voluntarily made for the non-profit body to carry on or carry out its purposes; and
    - no "identifiable direct valuable benefit" in the form of a supply of goods and services to the payer (or an associated person) arises or may arise in respect of the payment.

Payment is voluntarily made

15. The first part of the definition of "unconditional gift" requires the payment to be "voluntarily made". These words are not defined in the Act and so they need to be given an ordinary meaning that is consistent with the purpose of the definition of "unconditional gift" (see s 10(1) of the Legislation Act 2019).
16. For the purposes of the definition of "unconditional gift", the Commissioner considers:
    - a payment is voluntarily made if it is made freely by choice, is not required to be made or is optional;
    - a payment is not voluntarily made if it is made under a legal obligation;
    - a legal obligation includes a statutory obligation and in most instances it also includes an obligation under a contract; a payment made under a sense of moral obligation may still be voluntarily made; and
    - a non-profit body soliciting donations or recommending the amount of a donation does not in itself disqualify a payment from being voluntarily made.

[2] *Tax Information Bulletin* Vol 33, No 1 (February 2021): 42.

No identifiable direct valuable benefit

17. In the second part of the definition, a payment will not be an unconditional gift where an "identifiable direct valuable benefit" arises or may arise in respect of the payment, in the form of a supply of goods or services to the payer (or an associated person of the payer).
18. An "identifiable direct valuable benefit" is an advantage or gain in the form of a supply of goods or services to the payer (or an associated person) that is:
    - clearly able to be defined or identified;
    - sufficiently closely connected to the payment;
    - useful, important and of real value;
    - capable of being valued; and
    - not of only nominal worth.
19. To disqualify a payment from being an unconditional gift, the identifiable direct valuable benefit (in the form of a supply of goods or services) must arise "in respect of" the payment made. That the payer (or an associated person) receives the benefit is not by itself enough to take the payment out of the definition of unconditional gift. To be disqualified from being an "unconditional gift", a payment must have a sufficient link (or nexus) to the benefit arising in the form of a supply of goods or services.
20. Where the benefit will arise regardless of whether the payment is made, the connection between the benefit and the payment will not be sufficient, and so the payment will be an "unconditional gift". The courts have found that for a payment to be an "unconditional gift", any benefit arising must not be conditional or dependent on the payment being made.
21. *Case 8/2018* (2018) 28 NZTC 4,015 (TRA) was about whether amounts paid by the parents of children attending a private school were consideration for a supply of education services or unconditional gifts. Judge Sinclair found on the facts that because children were not excluded from attending the private school if their parents were unable to pay, their attendance at the school was not "conditional" on parents making the requested financial contributions.
22. However, she found the school was "dependent" on parents' contributions. This was because it was evident from the background facts before parents made the payments, including the related documentation and correspondence between the school and the parents, that if the parents had not made the contributions, the school would not have been able to operate. For this reason, Judge Sinclair found that in the circumstances a sufficient link could be established between the parents' contributions and the supply of education services the private school provided, so that the parents' contributions were consideration for the supply of education services, not unconditional gifts.
23. In determining whether a sufficient link exists between the payment and the benefit, the courts will take into account all the circumstances surrounding the payment.
24. In some circumstances, a non-profit body chooses to supply goods or services to a donor as a "thank you" acknowledging the donor's generosity. In this case, there will not usually be a sufficient link between the donor's payment and the supply of goods or services for the supply to be "in respect of" the donor's payment (see Example 8: Donation to charity concert in return for free tickets in **IS 20/09**). In that situation, the payment is not subject to GST.

Supplies of domestic goods and services in boarding houses

25. Where a private school provides boarding accommodation for a student in a school boarding house, the GST charged in respect of that supply of accommodation is subject to special rules.
26. Under the special rules set out in s 10(6), a lower rate of GST is chargeable than for ordinary taxable supplies on aspects of the supply of boarding accommodation – but only where the school boarding house qualifies as a "commercial dwelling" and the student's stay in the boarding house will be for longer than four weeks in total. The goods and services eligible for the lower GST rate are referred to as "domestic goods and services".
27. A "commercial dwelling" is defined in s 2 and includes hostels and boarding houses. For the purposes of this QWBA it is assumed that school boarding houses operated by private schools for student accommodation are "commercial dwellings".
28. The term "domestic goods and services", also defined in s 2, means the right to occupy premises like a boarding house together with any ancillary supplies like power, cleaning and other chattels related to the premises that are included along with the right to occupy. It does not include supplies of non-domestic goods or services such as meals, personal care and personal laundry services that might also be supplied and included within the overall fee charged by the school for boarding accommodation.

29. For GST purposes, the value of the supply of "domestic goods and services" is treated as being 60% of the actual consideration for the supply. In effect, this means GST is charged on the supply of "domestic goods and services" at the reduced rate of 9%.
30. Only domestic goods and services are subject to the lower GST rate, so the school must make an apportionment when invoicing boarding fees between supplies of domestic and non-domestic goods and services to parents. An ongoing apportionment percentage can be established using a factual basis. The school must keep sufficient records to support the apportionment basis.
31. However, any expenses incurred in providing domestic goods and services in a school boarding house do not need to be apportioned as they are all incurred in the course of making taxable supplies.
32. Where a boarding house is a "residential establishment" (as defined in s 2), the reduced GST rate applies from the start of any contract or arrangement for boarding accommodation where it is agreed the stay will be longer than four weeks in total. A boarding house will be a residential establishment if at least 70% of the students living in the boarding house will reside there for longer than four weeks. The period of residence does not need to be unbroken – the stay simply needs to be longer than four weeks in total. This means weekly boarders (ie, students who board five days a week during the term) are included. A period of residence is established by considering the legal arrangements between the parties.
33. Supplies of domestic goods and services to short-term boarders who stay for less than four weeks in total are subject to GST at the standard rate.

Examples

St Christopher's School, an independent church school, is a private school. It is registered for GST and it is also a registered charity under the Charities Act 2005 so it is a non-profit body for GST purposes.

Example 1: Tuition fees for attending private school

Michael has been accepted to attend St Christopher's School as a day student, starting in Year 9. The school advises that Michael's year 9 tuition fees are $5,500 per term, inclusive of GST. At the beginning of each term St Christopher's School issues a tax invoice to Michael's parents for the tuition fees payable for the upcoming term. The invoice includes GST of 15%.

Each family at the school also has a disbursement account for additional expenses like stationery, replacement uniform items, exam fees, and outings that are payable in addition to the tuition fees. The balance of the disbursement account is required to be paid monthly by direct debit. All the additional expenses are also subject to GST at 15%.

Example 2: Annual donation to scholarship fund

In its first newsletter for the school year, St Christopher's School includes a link to its website and a reminder from the school's Board that an annual donation from families or friends to help the school to fund its scholarship and building programme would be appreciated.

These payments are unconditional gifts as long as the families and friends make them voluntarily and get no identifiable direct valuable benefit in return. In these circumstances, the payments are not subject to GST.

Example 3: Donations to school instead of fees

St Christopher's School is offering students the opportunity to attend some "one-off" music lessons from a visiting "world-class" performer. Interested parents are asked to make voluntary contributions to cover the cost to the school of hosting the performer. The music department's newsletter makes it clear that the performer's visit will only go ahead if the school receives sufficient contributions and only children whose parents have made contributions will be able to attend the lessons.

These payments are not unconditional gifts. They are consideration for the supply of music lessons by the school. The supply of the music lessons is conditional and dependent on the parents making the payments to the school. The supply of these music lessons by the school, and the payments parents make for them are subject to GST.

Example 4: Donation to school with conditions

Jack is a businessperson with two children at St Christopher's School. Jack's company donates $6,000 to the school, for the school to use to install sunshades over the school playground. The company's $6,000 donation is an unconditional gift. The company makes the donation for the school (a non-profit body) to carry on or carry out its purposes, even though the funds are for a specified purpose.

Jack's company (or Jack and his children) does not receive an identifiable direct valuable benefit as a result of the company's payment. Any benefit Jack's children gain from using the sunshades is not an identifiable direct valuable benefit in the form of a supply of goods or services to an associate of the company. The sunshades are for the benefit of the school community as a whole.

The payment is not subject to GST.

Example 5: Plaque to recognise philanthropic donation

ABC Trust, a private philanthropic trust that a school alumnus has set up, makes a substantial distribution to St Christopher's School for its project to build a new hall. The school builds a new hall with the funds and in gratitude displays a plaque that states the hall was funded by the generous donation from the ABC Trust.

ABC Trust has not received an identifiable direct valuable benefit in the form of a supply of goods or services in respect of the distribution. The distribution is an unconditional gift for GST purposes. While the plaque acknowledges ABC Trust, it is not a "valuable" benefit and so does not prevent the payment from being an "unconditional gift".

The payment is not subject to GST.

Example 6: Supply of accommodation in a boarding house

St Christopher's School operates a boarding house for its students during term time. It enters into a contract with a family to supply their child with boarding accommodation for one 10-week term. The school has previously established, based on an analysis of past transactions, that it supplies 30% domestic goods and services and 70% non-domestic goods and services to its boarders. The school has kept records supporting that apportionment.

The GST-exclusive fee for a 10-week term boarding in the school's boarding house is $4,000:

- $4,000 × 30% = $1,200 (portion of boarding fee attributable to domestic goods and services, including cleaning, bed linen, heating, Wi-Fi, etc):

  $1,200 × 60% × 15% = $108 (GST on domestic goods and services)

- $4,000 × 70% = $2,800 (portion attributable to non-domestic goods and services including duty staff, pastoral care, meals, personal laundry services, activities etc):

  $2,800 × 15% = $420 (GST on non-domestic goods and services)

Total GST on the boarding fee is $108 + $420 = $528

Therefore, the total boarding fee inclusive of GST for a 10-week term is $4,528.

References

Legislative references

Charities Act 2005

Education and Training Act 2020

Goods and Services Tax Act 1985, ss 2 ("commercial dwelling", "consideration", "domestic goods and services", "non-profit body", "residential establishment", "unconditional gift"), 8, 10(2), 10(6)

Legislation Act 2019, s 10(1)

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QB 22/09 Income Tax – Payments made by parents to private schools and donation tax credits. (Question We've Been Asked, Inland Revenue, 2022). **taxtechnical.ird.govt.nz/questions-we-ve-been-asked/2022/qb-22-09**

QB 22/09: Income Tax – Payments made by parents to private schools and donation tax credits

This Question We've Been Asked explains when a parent's payment to their child's private school will qualify for a donation tax credit.

Another QWBA on the GST treatment of a parent's payment to their child's private school (**QB 22/08**) and more QWBAs on donation tax credits and payments by parents to state schools (**QB 18/10**) and state integrated schools (**QB 18/11**) can be found on our Tax Technical website.

Question

When will a parent's payment to their child's private school qualify for a donation tax credit?

Answer

Payments parents make to private schools are gifts for donation tax credit purposes where:

- the school is a donee organisation;
- the payment is money of $5 or more;
- the parent makes the payment voluntarily to benefit the school either generally or for a specific purpose or project; and
- the parent or child gains no material benefit or advantage in return for making the payment.

Key term

Parent also includes a child's guardian or caregiver who makes payments to a private school.

Private school means a school registered under s 214 of the Education and Training Act 2020.

Explanation

1. The Commissioner has been asked to clarify when payments parents make to private schools will qualify for a donation tax credit. (**QB 22/08: Goods and Services Tax – Payments made by parents to private schools**[1] clarifies the GST treatment of payments parents make to private schools.)
2. This QWBA complements the earlier QWBAs published for parents with children attending state schools (**QB 18/10**) and state integrated schools (**QB 18/11**).
3. Parents with children attending private schools are charged fees for their children to attend the school. There is a contractual relationship between the school and the parents for the provision of education and education-related goods and services in return for the payment of fees.
4. From time to time parents may choose to make donations to private schools. Where the school is a donee organisation, and the donation is a "charitable or public benefit gift", then parents may be entitled to a donation tax credit under s LD 1 for the donation.
5. In the past, there have been situations where parents have made "donations" to private schools in substitution for paying no or low school fees. The Commissioner's view on this practice was addressed in **Revenue Alert 14/01**. There are no donation tax credits for any payments paid by parents to private schools incorrectly described as "donations".

What is a donation tax credit?

6. A donation tax credit is a refundable tax credit available for charitable or other public benefit gifts that an individual makes to a donee organisation where the requirements in ss LD 1 to LD 3 are met.
7. An individual can claim a donation tax credit of one third of the payment amount. An individual's claim for a donation tax credit must be supported by appropriate donation tax receipts from the donee organisation. The Commissioner reviews an individual's claim and then notifies the individual of the amount of tax credit that will be allowed.

[1] Inland Revenue, 2022.

8. The sum of charitable or other public benefit gifts an individual taxpayer makes in a tax year must not exceed their taxable income for that year. Therefore the Commissioner will reduce the donation tax credits for gifts an individual taxpayer makes in a tax year if, in total, the credits claimed exceed the individual's taxable income for that year (see s 41A(3) and (4) of the Tax Administration Act 1994).

When are donation tax credits available?

9. Donation tax credits are available for payments of money of $5 or more that a parent makes to a private school only where they satisfy the requirements in ss LD 1 to LD 3. That is, donation tax credits are available where:
   - the private school is a "donee organisation"; and
   - the payment is "a charitable or other public benefit gift".

When is a private school a donee organisation?

10. A private school will be a donee organisation if it:
    - is registered as a charitable entity under the Charities Act 2005 or otherwise meets the requirements of s LD 3(2); and
    - appears on Inland Revenue's searchable list of approved donee organisations at **ird.govt.nz**.
11. Only donee organisations may issue donation tax receipts for donation tax credit purposes. Donations by parents to private schools that are not donee organisations will never qualify for donation tax credits.
12. For additional guidance on Donee organisations, see **OS 22/04 Part 2**: Charities and Donee Organisations: Part 2: Donee Organisations.[2]

When will payments to a private school be "charitable or other public benefit gifts"?

13. While s LD 3(1) defines the phrase "charitable or other public benefit gift" (and specifically excludes gifts made by will and forgiveness of debt), it does not define the word "gift". Aotearoa New Zealand courts say that the meaning of "gifting" and "gift" is to be determined by reference to the text and purpose of the legislation. That meaning is then to be applied by considering all of the arrangements that were actually entered into and carried out.[3]
14. In the absence of a statutory definition of "gift", the courts agree that for donation tax credit purposes the word "gift" should be given its ordinary and natural meaning.[4]
15. Based on case law, and taking into account the text of s LD 3(1) in the light of its purpose and its context,[5] the Commissioner considers that the ordinary and natural meaning of "gift" is a payment of money of $5 or more:
    - made voluntarily;
    - made by way of benefaction (ie, made to benefit the donee organisation); and
    - where the payer receives no material benefit or advantage in return.

Payment is made voluntarily

16. To qualify as a gift, a parent must make their payment to the private school voluntarily. For gifting purposes, this means the payment is made willingly, freely by choice.
17. As a general rule, a payment will not be made voluntarily if it is made under a contract or required to be made under some statutory or other legal obligation.[6]
18. However, the absence of a contract or a legal obligation on a parent to contribute to the school does not automatically mean payments are voluntary. There can be circumstances where, even though a parent has no legal obligation to make a payment to a private school, the payment still will not be considered "voluntary" for donation tax credit purposes.
19. For example, in *FCT v McPhail* the High Court of Australia found that contributions a parent made to a school building fund in return for reduced school fees were not gifts. In part, this was because the parent's agreement to contribute to the fund placed an obligation on the school to provide education facilities for the reduced fee. As a result, the court found that

[2] Inland Revenue, 2022.

[3] *The Church of Jesus Christ of Latter-Day Saints Trust Board and Coward v Commissioner of Inland Revenue* [2020] NZCA 143 at [28].

[4] For example, *Chief Executive of Ministry of Social Development v Broadbent* [2019] NZCA 201 at [80], *Coward* at [55] and *Federal Tax Commissioner v McPhail* (1968) 117 CLR 111 at 116.

[5] Section 10(1) of the Legislation Act 2019.

[6] *Leary v Federal Commissioner of Taxation* 80 ATC 4438 per Bowen CJ.

the contribution to the building fund was not a voluntary payment. Furthermore, it found the parent made the payment in the expectation that in return they would receive, and did in fact receive, a substantial concession in the fees charged for the education of their son.

20. Occasionally, a school or other parents may put pressure on a parent to make a payment and this can create a sense of moral obligation on the parent. A payment made under a sense of moral obligation is still voluntary. However, in some circumstances, pressure might also be evidence that a payment is being made under an arrangement between the school and the parent. If an objective analysis of the legal arrangements governing the payment and the surrounding circumstances establishes that the payment is not, in fact, voluntary, it will not be a gift.

Payment benefits the private school

21. The Commissioner considers case law[7] supports benefaction being an element of a gift in the context of donation tax credits. Benefaction is the idea that a gift should provide an advantage or benefit to the donee organisation. While the Court of Appeal did not discuss the idea of benefaction in *Coward*, or refer to *Leary*, in the Commissioner's view this should not be taken as meaning a court considering a different set of facts would not see benefaction as being an attribute of a gift for the purposes of s LD 1. Its presence demonstrates that a payment is made to advantage the donee organisation.

22. A payment made without benefaction will not be a gift in the ordinary sense of the word. For example, benefaction will not ordinarily be present where a donor's payment places a "countervailing material detriment"[8] on the donee organisation so that the organisation is prevented from benefiting (in whole or in part) from the payment.

23. In *Case J76*[9] a priest made payments to schools to ensure that disadvantaged children in his parish could access appropriate schooling. The priest argued his payments were gifts and therefore he was entitled to the equivalent of a donation tax credit. Judge Keane found there was no doubt that the payments were made out of charity, but the payments placed the schools under a contractual duty to educate the children and were made in return for the schools' educational services. The priest's payments were not gifts to the schools and so no donation tax credit equivalent was allowed.

24. To the Commissioner, benefaction is another measure for determining if a payment is a gift for donation tax credit purposes – along with whether the donor makes the payment voluntarily and whether they gain a material benefit in return for making the payment. If, following an objective analysis of the legal arrangements governing the payment and the surrounding circumstances, benefaction cannot be established, then the payment will not be a gift for donation tax credit purposes.

25. Such an interpretation of "gift" is consistent with the policy underlying the donation tax credit rules: that donation tax credits are available "to encourage New Zealand taxpayers to provide financial support to charities".[10] For example, if by receiving a payment the private school is placed under a countervailing obligation so that the school gains no advantage or benefit from the payment, then the Commissioner considers the payment is not truly a gift in the ordinary and natural meaning of the word.

No material benefit or advantage in return

26. A payment to a private school will not usually be a gift in circumstances where the payment results in a material benefit or advantage being conferred in return.

27. The material benefit or advantage does not need to come directly from the school. It also does not need to be received directly by the parent who made the payment (for example, the student may receive the education benefit).

28. A benefit or advantage will be considered "material" if it is of substance and can be valued or owned or both. For example, if the school newsletter advertises a parent's business in return for the parent making the payment, that would be a material benefit.

29. A benefit or advantage will not be material if it is intangible and cannot be valued or owned. An example of a non-material benefit or advantage is public acknowledgement, such as printing a parent's name in a school newsletter to acknowledge their gift.

[7] The Australian Federal Court in *Leary* found benefaction to be an essential idea of a gift, in its ordinary sense.

[8] Deane J in *Leary*: "It involves, in my view, the concept that the relevant transfer is by way of well doing in that the recipient will be advantaged, in a material sense and without any countervailing material detriment arising from the circumstances of the transfer, to the extent of the property transferred to him."

[9] *Case J76* (1987) 9 NZTC 1,451.

[10] *Coward* at [56].

30. Importantly, not every material benefit or advantage will necessarily disqualify a voluntary payment to a private school from being a gift. To disqualify a voluntary payment to a private school from being a gift, the benefit or advantage needs to arise *in return for* the payment. The extent and strength of any connection between the parent's payment and a benefit or advantage is an important factor in determining whether a payment is a gift.

31. For example, sometimes a school may want to thank and acknowledge the generosity of its parents and alumni by inviting them to a function or by giving them a token of appreciation. This is often referred to as "stewardship". In those situations, the benefit, even if material, does not disqualify a parent's payment from being a gift. This is because the parent had no expectation of being invited to the function when making the payment, so the link between the payment and the benefit is insufficient.

32. The Court of Appeal considered the strength of the link between a parent's payment and an education benefit or advantage in *Coward*. On the facts in *Coward* it was concluded there was an insufficient connection between the parent's payments to the church and any potential material benefit his child received when she was acting as a missionary overseas. However, the court noted that the facts in *Coward* were quite different from the "education benefit" cases[11] referred to in the decision.[12] In the "education benefit" cases, students received the clearly material benefit of an education and the parents gained the benefit of paying reduced or no fees for the education provided.

33. For example, in the Canadian decision *The Queen v Coleman* families made voluntary non-refundable payments to a religious charity and in return financial benefits were made available to students from those families to help with the cost of their education. The court found that the payments were not gifts because they had a strong link to the financial benefits to the families. The voluntary payments relieved the families from having to pay education costs.

34. The court determined the strength of the link by looking at a range of factors objectively, weighing them and applying them in a common-sense way. The factors included the relationship between the parties, correlation between the amounts paid and the value of the benefit gained, and the circumstances surrounding the payment.

35. In New Zealand, in *Case 8/2018* (2018) 28 NZTC 4,015 (TRA), a GST decision, the issue was whether amounts paid by the parents of children attending a private school were consideration for a supply of education services or unconditional gifts. Judge Sinclair found on the facts that while children could not be excluded from attending the private school if their parents were unable to pay, the school was still "dependent" on parents' contributions. It was evident from the background facts, including the related documentation and correspondence between the school and the parents, that if the parents had not made the contributions, the school would not have been able to operate. For this reason, Judge Sinclair found that in the circumstances a sufficient link could be established between the parents' contributions and the supply of education services by the private school, so that the parents' contributions were made for the supply of education services, and were not unconditional gifts.

36. While *Case 8/2018* relates to GST and so is only of limited relevance in the context of donation tax credits, it is an example of a situation where a court determined, after taking into account all the circumstances surrounding the payments made by the parents, that a sufficient link existed between the parents' payments and the material benefit of an education for reduced or no fees.

Can a gift be for a specific purpose?

37. Sometimes gifts will be made to a private school for a specific purpose or project – for example, to build a new gymnasium. The fact that a school seeks donations for a specific project does not, in itself, prevent the payment from being a gift. In the Commissioner's view, a gift made for a specific purpose will not cease to be a gift so long as no material benefit or advantage is provided in return for the payment.

38. Further, the fact that a parent's child may be among those who ultimately benefit from a school community project will not usually disqualify the payment from being a gift. However, the stronger the connection between a parent's payment and any material benefit or advantage they gain in return, the less likely it is that the payment will qualify as a gift.

[11] *McPhail*; *The Queen v Zandstra* [1974] 2 FC 254; *The Queen v Coleman* (2010) TTC 109; *Winters v Commissioner of Internal Revenue* 468 F 2d 778 (2nd Cir 1972).

[12] *Coward* at [61].

Can part of a payment be a gift?

39. The legal arrangements that the parties enter into and carry out, and the surrounding circumstances, establish the nature of the transaction. It is not open to parents and schools to later choose to describe a payment as comprising two separate payments – one for consideration (eg, a sale) and one made voluntarily for no consideration (ie, a gift) – if, in fact, it was a single transaction. For example, if the price paid for an item at a charity auction to raise funds for the school exceeds the value of the item, the school cannot treat the amount paid above its value as a gift. It may not issue a donation tax receipt in that situation.
40. However, a school may be able to issue a donation tax receipt where a parent makes two payments at the same time. For example, if a parent purchases tickets to an event the school is hosting and at the same time voluntarily supports the school by making an additional payment, the additional voluntary payment may be a gift. For the additional payment to be a gift, the parent must be allowed to attend the event regardless of whether they make any additional payment – that is, the ticket purchase must not depend on the parent making an additional payment. In that situation, the school may choose to issue a single invoice to the parent, so long as it clearly identifies the two separate payments (the ticket sale and the gift), and may issue a donation tax receipt for the gift the parent made.

Examples

Example 1: Annual donation to scholarship and building fund

The first newsletter for the school year includes a reminder from the private school's Trust Board that an annual donation from families or friends to help the school with funding its scholarship and building programme would be appreciated.

These payments are gifts for donation tax credit purposes providing they are voluntary and the donors gain no material benefit in return. If this is so, the school (which is a registered charity under the Charities Act 2005) can issue a donation tax receipt to the donors and individual donors can claim donation tax credits up to their allowable limit.

Example 2: Discounted tuition fees

A private school requests donations from parents for its building fund. It offers that in return any families who contribute more than $1,500 will enjoy a 5% discount off their child's annual tuition fees.

This payment is not a gift for donation tax credit purposes. In return for making the payment, the parents gain a material benefit in the form of reduced tuition costs.

Example 3: Contributions and no fees

St Christopher's School is a private secondary school operated by St Christopher's Church. St Christopher's Church is listed as a donee organisation on Inland Revenue's list of approved donee organisations.

Most parents are only charged low fees for their children to attend the school, and some families pay no fees at all. However, all families are asked to make contributions to the church. The contributions the church requests are determined by reference to the school's operating costs, the number of students attending the school and each family's circumstances. The school's enrolment handbook makes it clear that the school is reliant on the parents' contributions for its continuing operation.

The contributions made by parents are not gifts for donation tax credit purposes. Although a parent may have no legal or contractual obligation to contribute, the family gains a material benefit in return for making the requested contributions. That benefit is that their children receive an education at a school chosen by the parents. There is a strong link between the contributions and the benefit to the families. The amount of the payments relates to the education benefit. The payments place the church under a countervailing obligation to fund the school to educate the children. The church should not issue donation receipts to the parents for their contributions.

Example 4: Advertising

A private school asks families and alumni with businesses for donations to its scholarship fund. In return, it offers to place an advertisement for the business in its yearbook.

This payment is not a gift for income tax purposes. The supporter gains a material benefit in return for making the payment in the form of advertising.

Example 5: Fundraising dinner

Mi-young purchases a ticket to a quiz night that her children's private school, which is a donee organisation, is putting on as a fundraising event. The ticket costs her $80 and entitles her to attend the event. The school calculates it will raise approximately $50 from each ticket sold to go towards its new performing arts centre. None of the ticket price paid by Mi-young is a gift. The school has sold the ticket to Mi-young for $80. The school should not issue a donation tax receipt to Mi-young for any portion of the ticket price.

The situation would be different if the school sold each ticket for $30 and at the same time asked ticket purchasers to consider making a donation of $20, $50, $100 or any other amount. In this case, if Mi-young bought a ticket and opted to make a $50 donation, the school could issue a donation tax receipt to her for the $50.

While at the dinner, Mi-young is asked if she would like to contribute towards the school's scholarship fund. She agrees to make a donation of $500. The school is very grateful and advises Mi-young she will be acknowledged in its next newsletter. The school may issue a donation tax receipt to Mi-young for $500. The public acknowledgement of her generosity is not a material benefit.

Example 6: Charity auction

Mateo has purchased tickets to attend a cocktail party and charity auction to raise funds for a new swimming pool complex at his children's private school. The school is a donee organisation.

Before the auction night, the school asks for contributions of "prizes" that it can auction off to raise funds. Kaia, a local artist, donates a painting. The painting would ordinarily sell at one of Kaia's exhibitions for $700. The painting sells at the auction for $1,000. Although Kaia has donated the painting to the school, the school should not give her a donation tax receipt as she has not made a gift of money.

The auction sells various donated items to the guests. Mateo bids on a signed rugby jersey. A similar jersey recently sold in an online auction for $200. Mateo is keen to support the pool project so he bids $800 for the signed jersey and wins the auction. Although Mateo may have purchased the jersey for much more than the recent online auction price, no amount of the purchase price he paid is a gift. The school should not issue a donation tax receipt to Mateo.

Example 7: Christmas cards and donation

Felicity receives a letter from her children's private school, which is a registered charity, offering her the opportunity to purchase a pack of Christmas cards that students have painted for $20. On the order form, Felicity can also choose to add a donation to the school. She chooses to purchase one pack of cards and to make a donation of $30. She sends the card order away with her credit card details authorising a payment of $50.

The school then sends her the cards and a donation tax receipt for $30. This is correct. Felicity's $50 payment comprised two separately identifiable amounts she paid to the charity – $20 to purchase the cards and a $30 voluntary donation. The cards Felicity receives are not conditional on whether or not she also made a donation.

For additional examples that may be relevant to private school fundraising, see **QB 16/05**: Income Tax – Donee organisations and gifts.[13]

References

Legislative references

Charities Act 2005

Education and Training Act 2020

Income Tax Act 2007, ss LD 1 to LD 3

Legislation Act 2019, s 10(1)

Tax Administration Act 1994, ss 41A(3) and (4)

[13] *Tax Information Bulletin* Vol 28, No 7 (August 2016): 33.

Case references

Case J76 (1987) 9 NZTC 1,451

Case 8/2018 (2018) 28 NZTC 4,015

Chief Executive of Ministry of Social Development v Broadbent [2019] NZCA 201

Federal Commissioner of Taxation v McPhail (1968) 117 CLR 111 (Australia)

Leary v Federal Commissioner of Taxation 80 ATC 4438 (Australia)

The Church of Jesus Christ of Latter-Day Saints Trust Board and Coward v Commissioner of Inland Revenue [2020] NZCA 143

The Queen v Coleman (2010) TTC 109 (Canada)

The Queen v Zandstra [1974] 2 FC 254 (Canada)

Winters v Commissioner of Internal Revenue 468 F 2d 778 (2nd Cir 1972) (USA)

Other references

QB 16/05: Income Tax – Donee organisations and gifts, *Tax Information Bulletin* Vol 28, No 7 (August 2016): 33).
taxtechnical.ird.govt.nz/questions-we-ve-been-asked/2016/qb-1605-income-tax-donee-organisations-and-gifts

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taxtechnical.ird.govt.nz/operational-statements/2022/os-22-04-part-2

TECHNICAL DECISION SUMMARIES

Technical decision summaries (TDS) are summaries of technical decisions made by the Tax Counsel Office. As this is a summary of the original technical decision, it may not contain all the facts or assumptions relevant to that decision. A TDS is made available for information only and is not advice, guidance or a "Commissioner's official opinion" (as defined in s 3(1) of the Tax Administration Act 1994). **You cannot rely on this document as setting out the Commissioner's position more generally or in relation to your own circumstances or tax affairs**. It is not binding and provides you with no protection (including from underpaid tax, penalty or interest).

TDS 22/18: Income tax: timing of deduction; deduction for schedular income expenses

Technical decision summary - Adjudication

Decision date | Te Rā o te Whakatau: 6 July 2022

Issue date | Te Rā Tuku: 2 November 2022

Subjects | Ngā kaupapa

Income tax: timing of deduction, allowable deduction for schedular income expenses.

Abbreviations | Whakapotonga kupu

The abbreviations used in this document include:

CCS	Customer & Compliance Services, Inland Revenue
Commissioner or CIR	Commissioner of Inland Revenue
ITA	Income Tax Act 2007
TRA	Taxation Review Authority
TCO	Tax Counsel Office, Inland Revenue

Taxation laws | Ngā ture tāke

All legislative references are to the Income Tax Act 2007 (**ITA**) unless otherwise stated.

Facts | Ngā meka

1. The Taxpayer is an individual. The Taxpayer operates a farm on their property.
2. The Taxpayer claimed self-employment losses from farming in their 2020 income tax return. During the course of this dispute, the parties agreed the income from farming should be returned in the 2021 tax year. The Taxpayer considered this meant their expenses and depreciation loss from farming should also be re-returned in the 2021 tax year. However, Customer & Compliance Services, Inland Revenue (**CCS**) argued that these should remain returned in the 2020 tax year.
3. As well as operating a farm, the Taxpayer worked as an independent contractor in a different city from which the Taxpayer resides (the other city). The Taxpayer travelled to, and rented accommodation in, the other city to perform this work. The Taxpayer was required to attend the offices of the organisation they worked for in the other city on a weekly basis. The Taxpayer also travelled between their home city and the other city weekly to attend to the farm during this period.
4. The Taxpayer claimed expenses against their schedular income in the 2020 tax year. These consisted of the cost of travel between the two cities and meals and accommodation in the other city. CSS argued these expenses were not deductible.

Issues | Ngā take

5. The main issues considered in this dispute were:
   - whether a deduction for expenses and depreciation loss from farming was allowed to the Taxpayer in the 2020 tax year or the 2021 tax year; and
   - whether the Taxpayer was allowed the following deductions for expenses against their schedular income:
     - the costs of return trips between the Taxpayer's home city and the other city;
     - the costs of meals in the other city; and
     - accommodation expenses in the other city.

Decisions | Ngā whakatau

6. The Tax Counsel Office (**TCO**) concluded that:
   - the expenses and depreciation loss from farming is an allowable deduction to the Taxpayer in the 2020 tax year (and not the 2021 tax year); and
   - the schedular income expenses at issue were not an allowable deduction to the Taxpayer.

Reasons for decisions | Ngā take mō ngā whakatau

Issue 1 | Take tuatahi: Timing of expenses and depreciation loss deductions

7. The Taxpayer claimed self-employment losses from farming in their income tax return for the 2020 tax year, but agreed, during the dispute that the income from farming should be returned in the 2021 tax year. However, the Taxpayer considered the expenses and depreciation loss from farming should also, as a result, be returned in their 2021 income tax return, because the income to which the expenditure is related is income in the 2021 tax year, and income and related expenditure should be recognised together in the same period.

8. CCS argued that these expenses and the depreciation loss were incurred in the 2020 income year and should be deductible in the 2020 income tax return.

9. The statutory framework of the ITA for the recognition of income and expenses for tax purposes is clear. A global approach is required, under which income and allowable deductions are allocated to an income year under particular timing rules, rather than separate calculations of net income or loss for each source of income. While separate calculations for each source of income, or matching, might be required for financial accounting purposes, in the absence of explicit statutory direction it is not required for tax purposes.

10. A person's taxable income for a tax year is made up of the person's annual gross income and annual total deduction for the year, minus any available net loss.[1] Under s BC 3, a person's annual total deduction is the total of their deductions that are allocated to the corresponding income year.

11. Section DA 1 provides the general permission for allowable deductions, which relevantly provides that a person is allowed a deduction for an amount of expenditure or loss, including an amount of depreciation loss, to the extent that the expenditure or loss is incurred by them in deriving their assessable income (the general permission).

12. Deductions are allocated to an income year under s BD 4. The general rule under s BD 4 is that a deduction for an amount of expenditure or loss is allocated to the income year in which the expenditure or loss is incurred. Section BD 4(3) requires regard to be had to case law for allocation of expenditure or loss to an income year, which requires some people to recognise expenditure or loss on an accrual basis and others on a cash basis, and more generally defines the concept of incurrence.

13. Case law provides that the appropriate and proper system will depend to some extent on the nature of the taxpayer. For a non-trading individual, the cash system of accounting is the most appropriate, where income is "derived" when payment is received. In the case of a trading entity, the accrual system of accounting is usually appropriate and proper method of accounting for tax purposes. In an accrual system, income may be "derived" when it is earnt, and expenditure may be "incurred" independently of payment of expenses. The relevant income and corresponding expenditure are brought in or accrued in one year together, irrespective of actual receipt of money.[2]

[1] Sections BC 4 and BC 5.

[2] *Case F156* (1984) 6 NZTC 60,343 (TRA) at 60,346. See also *Whitworth Park Coal Ltd (in Liq) v Commissioner of Inland Revenue* [1961] AC 31; 28 TC 531 (HL).

14. In the leading case on when expenditure is "incurred", the Privy Council determined that for an outgoing to have been "incurred", the taxpayer must have either paid or become "definitively committed" to the expenditure.[3] The question is whether, "in light of all the surrounding circumstances, a legal obligation to make a payment in the future can be said to have accrued."[4]

15. TCO concluded that the expenses and depreciation loss at issue were deductible in the 2020 tax year (and not in the 2021 tax year) for these reasons:

- The Taxpayer should recognise their income and losses from farming, as a trading activity, on an accrual basis. Under an accrual system, the Taxpayer's farming income can be derived prior to receipt of payment and expenditure may be incurred independently of payment of expenses (and thereby income and expenditure incurred in earning that income are considered together).
- The Taxpayer's expenses from farming under dispute were invoiced during the 2020 income year, at which point the Taxpayer had a legal obligation and was definitively committed to pay the amounts invoiced. Therefore, these farming expenses were incurred by the Taxpayer in the 2020 income year and formed part of the Taxpayer's annual total deduction for the 2020 tax year under s BC 3.
- For the expenses that the Taxpayer did not provide invoices to support their deduction claim, the evidence showed these expenses have been paid by the Taxpayer during the 2020 income year. On this basis, these amounts would have been incurred by the Taxpayer during the 2020 income year at the latest, and therefore incurred in that year under s BD 4, and deductible to the Taxpayer in their 2020 tax year under s BC 3.
- In terms of the requirement that a "depreciation loss"[5] satisfies the general permission for deductibility (that is, the loss is incurred), s EE 1(4)(a) provides that an amount of depreciation loss is treated as being incurred in the income year for which it is calculated. On the basis that the amount of depreciation loss at issue was a calculation for the 2020 income year, the amount was treated as being incurred in the 2020 income year. It therefore forms part of the Taxpayer's total annual deduction for the 2020 tax year under s BC 3.

Issue 2 | Take tuarua: Deduction for schedular income expenses

16. The issue is whether the Taxpayer is allowed a deduction for expenses against their schedular income derived from their work as an independent contractor, made up of travel, meal and accommodation costs.

17. The Taxpayer argued the amounts under dispute were deductible because they were required to be in the other city on a weekly basis to perform their contracting work, but during the same period, required to attend to their farm in their home city. The Taxpayer also argued their meal expenses claim was deductible because the amount claimed is less than the additional cost of their meals when travelling as compared to the cost of meals at home.

18. CCS considered the amount at issue was not deductible to the Taxpayer because the expenses had not been incurred in deriving assessable income and were of a private nature.

19. As mentioned in Issue 1, the general permission for allowable deductions is provided in s DA 1. To satisfy the general permission, the expenditure must have the necessary relationship with both the taxpayer concerned and the gaining or producing of the person's assessable income.[6] In the Australian case, *Federal Commissioner of Taxation v Payne*,[7] the Australian High Court held that this means the outgoing must be incurred "in the course of" gaining or producing the assessable income[8], but excludes outgoings, which although incurred *for the purpose of* deriving assessable income, are not incurred *in the course of* doing so.[9]

20. The general limitations contained in s DA 2 override the general permission. Section DA 2(2) provides for the private limitation, which states a person is denied a deduction for an amount of expenditure or loss to the extent to which it is of a private or domestic nature.

[3] *Commissioner of Inland Revenue v Mitsubishi Motors New Zealand Ltd* (1995) 17 NZTC 12,351 (PC) at 12,353.

[4] At 12,355.

[5] "Depreciation loss" is defined in s YA 1 to mean "a loss that a person has in the circumstances set out in section EE 1(2)" and includes "a deduction for depreciation that a person was allowed under an earlier Act".

[6] *Commissioner of Inland Revenue v Banks* (1978) 3 NZTC 61,236 (CA). See also *Buckley & Young Ltd v Commissioner of Inland Revenue* (1978) 3 NZTC 61,271; [1978] 2 NZLR 485 (CA).

[7] *Federal Commissioner of Taxation v Payne* 2001 ATC 4,027 (HCA).

[8] *Banks* at 61,241 to 61,242; *Payne* at [9] and [25].

[9] *Payne* at [16].

21. The Court of Appeal in *Commissioner of Inland Revenue v Haenga*[10] recognised the application of the private limitation will often raise the same questions as that under the general permission. Relevantly, the Court recognised the answer is complicated where the advantage for which the expense is incurred may serve private and income earning purposes. Basic items, such as food, clothing and shelter, while in one sense have a relation to the derivation of income, are ordinary living expenses and properly characterised as consumption. Such expenses are not incidental and relevant to the derivation of income merely because they are necessary in that sense.[11]

Travel expenses

22. The Taxpayer sought to deduct their cost of travel between their home city and the other city in their personal car.
23. Applying the principle in *Payne*, the cost of travel between two unrelated places of work could not be said to be incurred in the course of deriving income from either and is therefore not an allowable deduction.
24. The question of the deductibility of travel expenses might also be framed in terms of the application of the private limitation, but for the specific rule under s DE 2 that allows a deduction for expenditure incurred for the "business use" of a motor vehicle, which overrides the private limitation.[12] However, the lack of sufficient connection between the expenses and assessable income that prevents deductibility under the general permission applies equally to the consideration of deductibility under s DE 2, given that "business use" is defined in s YA 1 to mean "travel undertaken by the vehicle wholly in deriving the person's income".[13]
25. TCO decided that the Taxpayer's travel expenses were not deductible because:
    - The travel occurred in the intervals between the two unrelated income producing activities, being the Taxpayer's farming activities in their home city and their work as an independent contractor in the other city, and not while the Taxpayer was engaged in either activity.
    - The costs arose from the need for the Taxpayer to be in a position where they could set about the tasks from which assessable income would be derived.
    - The costs were for travel "to one's work" and "from one's work", as opposed to "on work" for either activity.

Meal expenses

26. The Taxpayer claimed deductions for meal expenses incurred while the Taxpayer was in the other city. The Taxpayer argued the amounts claimed were the "extra cost" of the meals in the other city, where they were required to perform their work as an independent contractor, as compared to meals at home.
27. As a general proposition, case law has established that the cost of meals is not deductible, being a private matter, properly characterised as consumption and an ordinary living expense.[14]
28. The Taxation Review Authority (**TRA**) in *Case E80*[15] indicated that an extra cost on meals eaten "out of town" may have sufficient nexus with the income earning process if the quantum of extra cost could be proved. The TRA again considered the "extra cost" issue in *Case F117*[16], where they considered that the meal expenses in that case were deductible as the result of abnormal working conditions arising from the taxpayer's occupation and represented expenses over and above the ordinary cost of eating meals prepared at home. The case law indicates the deductibility of the "extra cost" of meals can only be deductible if incurred as a requirement of a taxpayer's work.[17]
29. TCO decided that the meal expenses were not deductible to the Taxpayer because:
    - The meal expenses were properly characterised as consumption and an ordinary living expense. They did not satisfy the statutory nexus with the derivation of income in the other city and were of a private and domestic nature.
    - To the extent any extra cost (compared to the cost of meals at home) could be proved, these were not incurred as a requirement of the Taxpayer's contracting work.

[10] *Commissioner of Inland Revenue v Haenga* (1985) 7 NZTC 5,198 (CA).

[11] *Haenga* at 5,206 to 5,207.

[12] See s DE 2(13).

[13] This is consistent with the discussion in Commissioner's Interpretation Statement **IS3448** "Travel by motor vehicle between home and work deductibility of expenditure and FBT implications".

[14] *Haenga*; *Federal Commissioner of Taxation v Cooper* 91 ATC 4396 (Full Federal Court, Sydney).

[15] Case *E80* (1982) 5 NZTC 59,421 (TRA).

[16] *Case F117* (1984) 6 NZTC 60,125 (TRA).

[17] See Commissioner's Interpretation Statement **IS 21/06** "Income tax and GST Treatment of Meal Expenses".

Accommodation expenses

30. The Taxpayer claimed deductions for accommodation expenses incurred while staying in the other city for their contracting work.

31. As a general principle, the costs of accommodation, like meals, are of a private nature, exclusively referrable to living as an individual member of society and a domestic expense relating to the household or family unit.[18]

32. Accommodation costs incurred to put oneself in a position to work, for example in a different location away from home, is not incurred in gaining or producing the income or incurred while carrying on the income producing activity and therefore does not satisfy the statutory nexus with the derivation of income.[19] However, this can be contrasted with a situation where expenses are incurred as a requirement to the income earning activity, and not merely due to the person's personal decision ordinarily arising on the provision of shelter.[20]

33. TCO concluded that the accommodation expenses incurred by the Taxpayer were not deductible because:
    - The accommodation expenses did not satisfy the statutory nexus with the derivation of income from contracting work and, being exclusively referrable to living as an individual member of society, are of a private and domestic nature.
    - The expenses were incurred to put the Taxpayer in a position to work in the other city rather than having been incurred in income derivation from that work. They had arisen because of the Taxpayer's personal preferences, as opposed to the peculiarities of the contracting work.

[18] *Haenga* at 5,206.

[19] *Case G57* (1985) 7 NZTC 1,251 (TRA); *Case M128* (1990) 12 NZTC 2,825 (TRA).

[20] *Commissioner of Inland Revenue v Hunter* (1990) 12 NZTC 7,169 (CA).

TDS 22/19: Whether weathertightness payments by the Crown are subject to GST

Technical decision summary - Adjudication

Decision date | Te Rā o te Whakatau: 6 May 2022

Issue date | Te Rā Tuku: 25 October 2022

Subjects | Ngā kaupapa

GST: grants and subsidies

Abbreviations | Whakapotonga kupu

The abbreviations used in this document include:

GSTA	Goods and Services Tax Act 1985
GST	Goods and Services Tax
Commissioner	Commissioner of Inland Revenue
WHRS Act	Weathertight Homes Resolution Services Act 2006
FAP	Financial Assistance Package scheme under the WHRS Act
Council	The local council
Council FAP Payments or Crown FAP Payments	Payments made under the Financial Assistance Package scheme by the local council or Crown
TCO	Tax Counsel Office, Inland Revenue
MBIE	Ministry of Business, Innovation and Employment
CCS	Customer and Compliance Services, Inland Revenue

Taxation laws | Ngā ture take

Goods and Services Tax Act 1985

Facts | Ngā meka

1. The Taxpayer is a GST registered body corporate providing services to the unit owners in an apartment complex. These services include repairing and maintaining the complex. The complex suffered weathertightness issues that required extensive remedial work.
2. The Taxpayer and unit owners lodged a claim under the Weathertight Homes Resolution Services Act 2006 (**WHRS Act**) and also commenced High Court proceedings against the local council (**Council**) and others they considered responsible for the defects. The Crown was not a party to the proceedings. In 2015 the parties to the proceedings entered a settlement agreement under which the Taxpayer and unit owners agreed to proceed with obtaining Government Financial Assistance Package (**FAP**) scheme under the WHRS Act.
3. Subsequently, the Taxpayer, the Crown (acting by and through the Ministry of Business, Innovation and Employment (**MBIE**)) and the Council entered the FAP Agreement. The FAP Agreement included obligations and acknowledgements that:
    - MBIE and the Council each agreed to pay 25% of the approved remedial costs – which does not include costs that result in betterment.
    - once the first payment is made s 125G of the WHRS Act applies to restrict civil proceedings and relief.

TECHNICAL DECISION SUMMARIES

- MBIE may act as the Council's agent to pay the Council's payments in accordance with the FAP Agreement.
- there is no admission of liability by MBIE and/or the Council.

4. Subsequently, MBIE made payments under the FAP Agreement to satisfy the Crown's payment obligations (**Crown FAP Payments**) and those of Council (**Council FAP Payments**) as the Council's agent. For reasons that are unclear, the total Crown FAP Payments were greater than the total Council FAP Payments. The Taxpayer distributed an amount to unit owners in late 2019 as a refund for levies not required because there was no further work to be done or paid for. The Taxpayer filed GST returns on the basis that the Crown FAP Payment was not subject to GST.

Issues | Ngā take

5. The issue considered in this dispute was:
   - whether the Crown FAP Payments received by the Taxpayer were "payments in the nature of a grant or subsidy" under s 5(6D) and therefore, deemed consideration for a supply that is subject to GST under s 8.
6. The GST treatment of the Council FAP Payments to the Taxpayer was not in issue.

Decisions | Ngā whakatau

7. TCO decided that:
   - The Crown FAP Payments to the Taxpayer are gratuitous payments to encourage or promote the repair of leaky buildings. The payments have not been made for the Taxpayer's personal use or benefit, or for the personal use or benefit of a relative of the Taxpayer. Accordingly, the payments are in the nature of a grant or subsidy for the purposes of s 5(6D) of the Goods and Services Tax Act 1985 (**GSTA**). The Crown FAP Payments are therefore deemed to be consideration for a supply under s 5(6D), and subject to GST under s 8, of the GSTA.
   - To the extent the difference between the Crown FAP Payments and the Council FAP Payments is because the Crown has funded any part of the Council's obligations under the FAP Agreement, the relevant amount would be a settlement or compensation payment rather than a payment in the nature of a grant or subsidy for the purposes of s 5(6D).

Reasons for decisions | Ngā take mō ngā whakatau

Issue | Take: Whether the payments are in the nature of a grant or subsidy for the purposes of s 5(6D)

8. The issue was whether the payments received by the Taxpayer were a "payment in the nature of a grant or subsidy" under s 5(6D). If they were, then there is a deemed supply for consideration and the payments will be subject to GST.
9. Customer and Compliance Services, Inland Revenue (**CCS**) argued s 5(6D) applied because the Crown FAP Payments were made without obligation to assist the Taxpayer to repair the property and this benefits both the Taxpayer and the wider public. CCS argued the exclusions (in s 5(6E)) to the term "payment in the nature of a grant or subsidy" did not apply.
10. The Taxpayer argued the Crown FAP Payments were not payments in the nature of a grant or subsidy and s 5(6D) did not apply. The payments, whether Crown or Council funded, arose under the FAP Agreement and were, in form and substance, payments to settle any legal liability of the Crown and of the Council. The payments were not made to assist or enable the Taxpayer to provide goods and services considered of public benefit in accordance with any Government objective. Further, it was argued that the payments were in any case for the personal use and benefit of the Taxpayer and its owners and so the exclusion from being a payment in the nature of a grant or subsidy in s 5(6E) applied.
11. Section 5(6D) deems any payment in the nature of a grant or subsidy made on behalf of the Crown to any person in relation to or in respect of their taxable activity to be consideration for a supply of goods and services by the person to whom or for whose benefit the payment is made. The supply is deemed to be in the course or furtherance of that person's taxable activity.
12. The key requirements for s 5(6D) are that there is a payment:
    - in the nature of a grant or subsidy
    - made on behalf of the Crown or by any public authority
    - made to a person (not being a public authority)
    - made in relation to or in respect of that person's taxable activity.

13. The issue to be considered was the first bullet point – whether the payments were in the nature of a grant or subsidy. Included in this consideration was whether the specific exclusion for personal use payments and benefits in s 5(6E) applied.

Payments in "the nature of a grant or subsidy" for the purposes of s 5(6D)

14. At the time s 5(6D) was enacted the guidance noted that the common thread in the definitions of grant or subsidy is that there "is a gift or assignment of money by government or a public authority out of public funds to a private or individual or commercial enterprise deemed to be beneficial to the public interest."[1]

15. Case law indicates the focus is on the character of the payment from the payer's perspective, not its receipt in the hands of the payee, and recognises that a subsidy payment changes the nature of a contract from an ordinary commercial contract.[2] The Commissioner's previously published public guidance[3] has considered factors which may indicate that a payment is in the nature of a grant or subsidy, including where the payment is:

- a gift, in the sense that there is no obligation to make it
- a special assistance payment
- to promote or encourage an industry or enterprise
- out of public funds
- beneficial to the public interest.

16. In summary, it was considered that the case law indicates a payment in the nature of a grant or subsidy is a gratuitous payment made by the Crown, out of public funds, to promote or encourage an industry or enterprise and that the payment is special assistance, beneficial to the public interest.[4]

17. The Taxpayer argued that the Crown FAP Payments were not the sort of payments Parliament envisaged as being subject to GST as payments in the nature of a grant or subsidy. Consequently, TCO considered the legislative background and concluded that the Government's intention was that GST would be payable on grants and subsidies received by a registered person in the course of their taxable activity. The recipients of these grants are supplying services to the Crown through the use to which they put the grant money they receive and the purpose of s 5(6D) is to make such payments subject to GST.

18. TCO concluded that the Crown FAP Payments were in the nature of a "grant or subsidy" because:

- The payments were gratuitous payments by the Crown for the purpose of assisting with the cost of repairing the Taxpayer's property to remedy problems arising from it not being weathertight. The payments were gratuitous because they were not made in response to any duty of care owed to the Taxpayer or unit owners.[5]
- The FAP Agreement does not acknowledge or otherwise create a duty of care and does not represent an admission of any form of liability by the Crown to the Taxpayer.
- The Crown FAP Payments are special assistance payments, deemed to be beneficial to the public interest.
- To the extent it is necessary to conclude that the Crown FAP Payments are beneficial to the public interest, or enable the Taxpayer to provide services to members of the public at a concessionary price, this criterion has been satisfied. This is because it is in public interest that these properties remain habitable by the homeowner and other New Zealanders in the future, and the homeowners were able to have their units repaired at a reduced cost.

[1] Commissioner's public statement: "Application of GST to Government Grants and Subsidies" (*Tax Information Bulletin* Vol 3, No 1 (July 1991)). This wording is from the Canadian case, *GTE Sylvania Canada Ltd v R* [1974] 1 FCR 726.

[2] *Kena Kena Properties Limited v Attorney-General* (2002) 20 NZTC 17,433 (PC); *Director-General of Social Welfare v De Morgan and anor* (1996) 17 NZTC 12,636 (CA).

[3] Interpretation Statement IS 3427 "Treaty of Waitangi Settlements – GST Treatment" (*Tax Information Bulletin* Vol 14, No 9 (September 2002)) and Interpretation Statement IS 3387: "GST Treatment of Court Awards and Out of Court Settlements" *Tax Information Bulletin* Vol 14, No 10 (October 2002).

[4] *Kena Kena Properties Limited*; *De Morgan* (CA); *De Morgan and Anor* (1996) 17 NZTC 12,441 (HC); *Reckitt & Colman Pty Ltd v FCT* 4 ATR 501; *First Provincial Building Society Ltd v FCT*; *Case Q13* (1993) 15 NZTC 5,078 and *Placer Development Ltd v Commonwealth of Australia* (1969) 121 CLR 353.

[5] *Attorney-General v Body Corporate 200200 (Sacramento)* [2007] 1 NZLR 95 supports the view there is no duty of care on the Crown.

TECHNICAL DECISION SUMMARIES

Payments for personal use or benefit of a person excluded under s 5(6E)

19. Under s 5(6E), a payment will not be in the nature of a grant of subsidy for the purposes of s 5(6D) if the payment is "for the personal use and benefit of the person or, as the case may be, a relative (as defined in paragraph (a) of the definition of that term in section YA 1 of the Income Tax Act 2007) of the person".[6]

20. TCO considered that the exclusion in s 5(6E)(b)(ii) does not apply to the Crown FAP Payments because:

- The Taxpayer is not a person for the purposes of s 5(6E)(b)(ii). The definition of "person" in s 2 of the GST Act includes companies and applies "unless the context otherwise requires". In the context of s 5(6E)(b)(ii) it was considered that the term refers only to a natural person (ie, not a company). The subsection excludes payments for the personal use and benefit of the recipient person or a "relative" of the person. It was concluded that only a natural person can personally use a grant or subsidy. This position finds some support in the use of the term "relative" in the subparagraph. In any event, the Taxpayer cannot use the Crown FAP Payments personally as it is restricted in how it can use funds by legislation.
- The IRD guidance that sets out the purpose of s 5(6D) and (6E)[7] supports this conclusion. The Crown FAP Payments are not benefits similar to those paid under the Social Security Act (such as family support tax credits), which can be used by the recipient (who, given the nature of the payments, will be a natural person) for whatever purpose the recipient desires.
- TCO did not agree with the argument that s 5(6E)(b)(ii) applies to the Crown FAP Payments because some of the 'settlement monies' were ultimately distributed to the unit owners to use as they wished. The Crown FAP Payments were paid to the Taxpayer. The amounts distributed to the unit owners by the Taxpayer were not a distribution of the Crown FAP Payments but rather, as described on the credit notes distributed, a refund of levies (previously paid by the unit owners) not required.

GST treatment of compensation or settlement payments

21. The parties agreed that a compensation or settlement payment will not be a payment in the nature of a grant or subsidy. A payment for loss or damage is not consideration for a supply.

22. There is some crossover between the question of whether the Crown FAP Payments were gratuitous and whether the payments were compensation or settlement payments. Particularly relevant is the Crown has no duty of care to the Taxpayer in relation to weathertightness issues.

23. TCO considered the object of compensation is to financially restore the injured person to the position he or she would have occupied had the breach not occurred.[8] Where physical damage to a building has occurred as a result of the negligence of a builder, designer or local authority, the primary measure of damages is the cost of the remedial work or reinstatement.[9]

24. Case law indicates that when determining whether a payment is a compensation payment and not consideration for a supply the emphasis is on the legal arrangements actually entered into and carried out. For a payment to be consideration for a supply the courts focus on whether there is a nexus between the supply and the consideration. No such nexus is established where the payment is a compensation or settlement payment. Further, a payment to settle a dispute and avoid litigation is not a "payment in the nature of a grant and subsidy" for the purposes of s 5(6D).[10]

25. The position in the Commissioner's guidance on the GST treatment of court awards and out of court settlements[11] is that a payment may be made for the purpose of settling a dispute or to compensate for a loss even where the payer does not accept any liability for the loss. This requires determination of whether the payment is for the purpose of compensating for a loss.

26. When the court proceedings were settled, the Taxpayer and the Council agreed to participate in the FAP scheme under the WHRS Act. The provisions of the WHRS Act applied notably:

[6] Unless declared to be a taxable grant or subsidy under s 5(6E)(a)(ii).

[7] *Tax Information Bulletin* Vol 3, No 1 (July 1991).

[8] *Attorney-General v Geothermal Produce New Zealand Ltd* [1987] 2 NZLR 348 (CA).

[9] *Invercargill City Council v Hamlin* [1996] 1 NZLR 513.

[10] *Commissioner of Inland Revenue v New Zealand Refining Co Ltd* (1997) 18 NZTC 13,187 (CA); *New Zealand Refining Co Ltd v Commissioner Inland Revenue* (1995) 17 NZTC 12,307 (HC).

[11] Interpretation Statement IS 3387: "GST Treatment of Court Awards and Out of Court Settlements" *Tax Information Bulletin* Vol 14, No 10 (October 2002).

- s 125BA(2)(b) requires litigation to be discontinued (s 125BA makes no reference to the Crown).
- Section 125F gives the Crown protection from liability as a result of repairs undertaken through the FAP scheme.
- Section 125G provides that claimants who enter into the FAP scheme may not name the contributing party (ie, in this case the Crown) or any additional contributing party as defendant in any civil proceedings.

27. TCO considered the WHRS Act and legislative history and concluded that:
    - The purpose of s 125G of the WHRS Act (combined with the contribution criteria requiring a claimant who has commenced civil proceedings against the Council to discontinue those civil proceedings entirely) was to divert funds from taxpayers and the Council away from litigation towards the repair of the property.
    - The reason for the inclusion of the Crown (as a contributing party) in the immunity provided by s 125G was out of an abundance of caution and to ensure that the Crown preserve its position of not incurring liability for leaky homes which the courts have found does not extend to the Crown.
28. That the Crown had no liability for leaky homes was the understanding of the Honourable Maurice Williamson (Minister for Building and Construction) when the FAP Bill was being enacted in 2011. At the first, second, and third readings of the Bill the Minister emphasised that the Crown did not need to make any such payment to homeowners and referenced the failed court attempts to hold the Crown liable for leaky homes damages. This view is consistent with the case law.
29. The Court of Appeal has held that the Building Industry Authority (**BIA**) (replaced in November 2004 by the Department of Building and Housing which became part of MBIE in July 2012) had no duty of care to property owners of homes with monolithic cladding systems to exercise reasonable care in connection with its statutory responsibilities.[12] The Supreme Court followed this reasoning in confirming that the BIA was not under a duty of care to property owners.[13]
30. The courts have taken a different view when considering the liability of territorial authorities/councils to property owners.[14] In summary, the courts' approach effectively means that MBIE owes no duty of care to property owners facing weathertightness issues as there is insufficient causality between the MBIE and homeowners. However, local authorities can owe a duty of care to property owners.
31. TCO concluded that the Crown FAP Payments were not compensation or settlement payments and neither is it appropriate to treat the Crown FAP Payments as part of one overall FAP payment. In analysing the nature of a supply, the courts look at the underlying contract and what the supplier provided to the recipient.
32. The availability of the Crown FAP Payments and the Crown's immunity from civil proceedings arose under the WHRS Act. The relationship between the Crown FAP Payments and the settlement of the litigation arises from the Taxpayer's decision to repair the property through the FAP scheme. The Taxpayer was in legal proceedings involving the Council. The Taxpayer decided to repair the property under the FAP scheme instead of pursuing its legal claim against the Council (and others). As the focus is on the nature of the payment from the payer, not its character in the hands of the payee, whether the Taxpayer would have settled the litigation in the absence of the Crown FAP Payments is not relevant.
33. There was a discrepancy between the Crown FAP Payments and the Council FAP Payments despite the obligation of each party to pay 25% of approved costs under the FAP agreement. To the extent that the Crown has funded any part of the Council's payment obligations under the FAP Agreement, the amount would be considered to be a settlement or compensation payment. This is because the nature of the payment must be determined by the legal arrangements actually entered into and the rights and duties created. The parties agree the Council payment obligations are settlement or compensation payments and this would not be altered by the Crown partially funding the Council's payment obligations (if that is the reason for the disparity).

[12] *Attorney-General v Body Corporate 200200 (Sacramento)* [2007] 1 NZLR 95.

[13] *North Shore City Council v Attorney-General* [2012] 3 NZLR 341.

[14] *North Shore City Council v Body Corporate 188529 (Sunset Terraces & Ors; North Shore City Council v Body Corporate 189855 (Byron Avenue) & Ors* [2011] 2 NZLR 289.

Consistency with Inland Revenue publications

34. The conclusion in this matter was considered to be consistent with the Commissioner's Statement on the GST treatment of MBIE leaky home payments.[15] That statement sets out the Commissioner's position that a payment under the FAP scheme is not a payment in respect of any actual supply of goods and services made by the body corporate in return for that payment. The Commissioner considers that the payments are in the nature of a grant or subsidy from the Crown under s 5(6D) and are therefore deemed to be in response to a supply from the body corporate. As a result, these payments are subject to GST.

35. A GST registered body corporate which receives such payments is therefore obliged to include the GST component in its GST return and to pay for any net GST output tax. A body corporate which is not registered (and not liable to be registered) for GST is not obliged to account for GST.

36. TCO also considered the Commissioner's published guidance on Treaty of Waitangi settlements.[16] Treaty settlements are not subject to GST because the settlement payments are not "consideration" for the supply of any goods or services made by the relevant Māori claimant group to the Crown. The Commissioner considers a Treaty settlement payment made by the Crown to provide redress for historical wrongs that were breaches of the Treaty of Waitangi is not gratuitous or a gift as it was "occasioned by a moral, and possibly legal, obligation [on the Crown] to correct the wrong done".

37. This obligation to compensate for breaches of New Zealand's founding document can be contrasted to the weathertightness issue where the Crown had no duty of care to the Taxpayer and no moral obligation to compensate the Taxpayer for the loss suffered from owning a leaky building.

[15] Commissioner's Statement CS 20/05, "GST treatment of payments received by a GST registered body corporate from the Ministry of Business, Innovation and Employment under the Leaky Homes Financial Assistance Package", *Tax Information Bulletin* Vol 32, No 10 (November 2020) at pages 2-4.

[16] Interpretation Statement IS 3427 "Treaty of Waitangi Settlements – GST Treatment" (*Tax Information Bulletin* Vol 14, No 9 (September 2002)).

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Technical Standards sits within Legal Services and contributes the standard practice statements which describe how the Commissioner of Inland Revenue will exercise a statutory discretion or deal with practical operational issues arising out of the administration of the Inland Revenue Acts. They also produce determinations on standard costs and amortisation or depreciation rates for fixed life property used to produce income, as well as other statements on operational practice related to topical tax matters. Technical Standards also contributes to the "Your opportunity to comment" section.

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