



CHARTERED ACCOUNTANTS
AUSTRALIA + NEW ZEALAND

DavidCo Limited
CHARTERED ACCOUNTANTS

Level 2, Shortland Chambers
70 Shortland Street, Auckland
PO Box 2380, Shortland Street
Auckland 1140
T +64 9 921 6885
M +64 21 639 710
E arun.david@davidco.co.nz
W www.davidco.co.nz

WEEKLY COMMENT: FRIDAY 24 JULY 2020

1. The *COVID-19 Response (Taxation and Other Regulatory Urgent Measures) Act 2020* (the “second COVID-19 Tax Amending Act”), which received the Royal assent on 30 April 2020, contains a number of amendments to various Acts. The main income tax amendment is the provision of a new election to carry back tax losses incurred in 2019-20 and 2020-21, including a new anti-avoidance rule and a change to the provisional tax estimation rules.
2. Last week I looked at the new rules as they apply to non-company taxpayers and company taxpayers that are not in a group of companies. This week, I will look at the rules as they apply to companies in a wholly-owned group and an ordinary group, and the new anti-avoidance rules applying to arrangements to allow losses to be carried back.

Company in a wholly-owned group

3. A company that is in a wholly-owned group of companies during the offset ownership period (i.e. the period for which shareholding continuity requirements are met – refer to paragraph 17 in last week’s *Weekly Comment*) can carry back a net loss as follows:
 - (a) The company itself must have a net loss for the net loss year, required under s. IZ 8(3)(a);
 - (b) Under s. IZ 8(3)(b), the net loss that can be carried back (the “available tax loss”) cannot exceed the “group loss excess”, for the loss ownership period, of all companies in the wholly-owned group of companies, calculated as:
 - (i) The total net loss of all companies in the group with a net loss for the loss ownership period; less
 - (ii) The total net income of all companies in the group with net income not covered by non-refundable tax credits for the loss ownership period;
 - (c) The taxable income allowed to be offset is the smallest of:
 - (i) The company’s own net income for the “income ownership period” (which may be its entire initial taxable income for the taxable income year if shareholding continuity is maintained for the whole taxable income year) plus group income that can be offset subject to the group loss offset rules, as provided in s. IZ 8(7)(a);
 - (ii) The company group’s remaining “group loss excess” after subtracting net loss amounts carried back and used by other companies in the wholly-owned group, as provided in s. IZ 8(7)(b); and

(iii) The elected amount of the group's remaining "group loss excess", as provided in s. IZ 8(7)(c).

4. The article on the loss carry back rules in *Public Act 2020 No 8 and No 10* ("the Public Act 2020 Article") contains Example 5 on pages 9 and 10 of a wholly-owned group consisting of three companies with group taxable income in 2019-20 (Year 1) and a group tax loss in 2020-21 (Year 2) as follows:

(a) In Year 1:

(i) Company A has taxable income of \$100,000;

(ii) Company B has a tax loss of (\$60,000); and

(iii) Company C has taxable income of \$40,000;

(b) Company B's Year 1 tax loss of (\$60,000) is offset against Company A's Year 1 income of \$100,000;

(c) The group income for Year 1 is consequently \$80,000 (arising from income of \$40,000 each in Company A and Company C);

(d) In Year 2:

(i) Company A has taxable income of \$75,000;

(ii) Company B has a tax loss of (\$50,000); and

(iii) Company C has a tax loss of (\$75,000);

(e) The group can elect to carry back a net loss from Year 2 to Year 1 under s. IZ 8(3) because:

(i) There are two companies in the group, Company B and Company C, each with a net loss in Year 2 of (\$50,000) and (\$75,000) respectively, so the requirement in s. IZ 8(3)(a) is met; and

(ii) After setting off the taxable income of Company A in Year 2 of \$75,000, there is a "group loss excess" in Year 2 of (\$50,000), so the requirement in s. IZ 8(3)(b) is met;

(f) The maximum amount of its Year 2 net loss of (\$50,000) that Company B can carry back is the smallest amount of the following:

(i) Company B's own Year 1 income of \$0 plus \$50,000 of the group's Year 1 income, which is the amount that could be offset by Company B's Year 2 loss, i.e. a total loss carried back of (\$50,000), as given by s. IZ 8(7)(a); and

(ii) Whatever remains of the group's excess loss in Year 2 of (\$50,000) after deducting any Year 2 net loss carried back by Company C, which may be less than (< \$50,000) as given by s. IZ 8(7)(b); and

(iii) If Company B so elects, a smaller amount than either of the above amounts, as given by s. IZ 8(7)(c).

- (g) Similarly, the maximum net loss from Year 2 that Company C can carry back is the smallest of the following amounts:
 - (i) Company C's own Year 1 income of \$40,000 plus \$35,000, being the amount group's Year 1 income that could be offset by Company C's remaining loss after offsetting its own Year 1 net loss, i.e. a total loss carried back of (\$75,000), as given by s. IZ 8(7)(a); and
 - (ii) Whatever remains of the group's excess loss in Year 2 of (\$50,000) after deducting any amount carried back and used by Company B, – i.e. (\$50,000) or less, as given by s. IZ 8(7)(b); and
 - (iii) If Company C so elects, a smaller amount than either of the above amounts, as given by s. IZ 8(7)(c).
 - (h) In other words, the maximum loss that can be carried back by the group is the group net loss for Year 2 of (\$50,000);
 - (i) How this is divided up between Company B and Company C (being the 2 companies with a net loss each in Year 2) has to be notified to the Commissioner;
 - (j) The time for notifying the Commissioner of the election to carry back the loss is extended until the time for filing the 2021 income tax return.
5. In the above example, the amount of the group net loss that can be carried back will be increased if the company with the profit in Year 2, Company A, has non-refundable tax credits that can be used to settle the tax payable on its income. Example 6 in the Public Act 2020 Article is as follows:
- (a) Company A's Year 2 income of \$75,000 includes a fully imputed dividend of \$36,000;
 - (b) The imputation credits included in Company A's taxable income are \$14,000 (the imputation credits to fully impute the cash dividend of \$36,000);
 - (c) Therefore, the tax on \$50,000 of Company A's income is settled through the non-refundable imputation credits of \$14,000;
 - (d) This means that it is only necessary to use (\$25,000) of Company B's and Company C's combined net loss for Year 2 of (\$125,000) to offset the remainder of Company A's Year 2 income of \$25,000;
 - (e) Therefore, the group loss excess that could be carried back increases to \$100,000;
 - (f) However, the group's income for Year 1 is only \$80,000;
 - (g) Therefore the group loss excess that can be carried back is limited to \$80,000; and
 - (h) The remaining Year 2 group loss excess of \$20,000 has to be carried forward.
6. (Note: Example 6 in the Public Act 2020 Article shows a loss to carry forward of (\$45,000), but appears to ignore the Year 2 loss offset of (\$25,000) against Company A's remaining Year 2 income of \$25,000. Inland Revenue has noted later in the Public Act 2020 Article under "frequently asked questions" that the requirement to offset losses in a group before carrying a loss back must be applied to a wholly owned group.)

A company in a group (but not a wholly-owned group)

7. A company that is in a group of companies at a time in the offset ownership period can carry back a net loss as follows:
 - (a) The net loss that can be carried back cannot exceed the net loss incurred in the “loss ownership period” (see paragraph 18(a) in last week’s *Weekly Comment* - 17 July 2020);
 - (b) The taxable income allowed to be offset is the smallest of:
 - (i) The company’s taxable income for the taxable income year;
 - (ii) The company’s net income for the “income ownership period” (see paragraph 18(b) in last week’s *Weekly Comment* - 17 July 2020); and
 - (iii) The part of the elected net loss carried back that is made available to other members of the group of companies in the taxable income year (subject to the rules specified in paragraph 8 below); and
 - (iv) The elected amount of the company’s net loss carried back.
8. The group loss offset rules in subpart IC and the part-year loss offset rules in subpart IP apply with the following amendments when a company makes a net loss carried back available to other company group members:
 - (a) The “tax loss” referred to in s. IC 1 is the amount by which the company’s loss carried back exceeds its own taxable income for the taxable income year;
 - (b) The “commonality period” referred to in s. IC 6 for group loss offsets are the “offset years” (i.e. the taxable income year and the net loss year);
 - (c) A net loss to be carried back must arise in the part of the loss ownership period that is included in the common span (which, using the definition in s. IP 2, is the part of the loss ownership period in which the requirements for commonality of ownership are met);
 - (d) The available tax loss used by a group company cannot exceed the net income that the group company derives in the portion of the income ownership period that is included in the common span; and
 - (e) The company that carries back the net loss and the group company that uses the net loss must provide the Commissioner with the part-year financial statements required under s. IP 6.

New anti-avoidance rule

9. A new anti-avoidance provision has been inserted as s. GB 3B, with effect from 15 April 2020, which applies when:
 - (a) A share in a company (the “loss company”) or another company has been subject to an arrangement, including an arrangement directly or indirectly altering rights attached to the shares; and
 - (b) The arrangement allows the loss company to meet the requirements of s. IZ 8 (i.e. to carry back a net loss); and

- (c) A purpose of the arrangement is to defeat the intent and application of s. IZ 8.
10. If s. GB 3B applies, the loss company is treated as not meeting the requirements of s. IZ 8 in relation to the shares.
11. Section GB 4, which concerns arrangements for grouping tax losses has also been amended to stop a company grouping its carried back tax loss with other group companies if there is an arrangement involving shares that allows the grouping to occur.
12. The Commissioner has issued Interpretation Statement IS 20/03 *Income tax – sections GB 3B and GB 4 of the Income Tax Act 2007 – Temporary Loss Carry-Back regime*. It is noted that sections GB 3B and GB 4 each have the following three requirements:
- (a) A share in the relevant company is “subject to an arrangement” (which includes “an arrangement directly or indirectly altering rights attached to the shares”);
 - (b) The arrangement “allows” the relevant company “to meet the requirements” of the temporary loss carry-back regime;
 - (c) A “purpose” of the arrangement is “to defeat the intent and application” of the temporary loss carry-back regime.
13. An “arrangement” is defined in s. YA 1 as meaning an agreement, contract, plan, or understanding, whether enforceable or unenforceable, including all steps and transactions by which it is carried into effect. Case law has described an arrangement as embracing all kinds of concerted action by which persons may arrange their affairs for a particular purpose or to produce a particular effect.
14. It is noted in IS 20/03 that “allows” means that the arrangement must permit or enable a company to obtain or maintain compliance with the ownership continuity or ownership commonality requirements during the relevant period, as required by s IZ 8.
15. The Commissioner considers the test as to whether an arrangement “defeats the intent and application” of a particular provision under a specific anti-avoidance provision such as s GB 3B or s GB 4 is in effect the same test as the parliamentary contemplation test under the general anti-avoidance provision (s BG 1), as set out by the Supreme Court in *Ben Nevis Forestry Ventures Ltd v CIR* [2008] NZSC 115. Both tests are aimed at transactions and arrangements that in juristic or legal terms (that is, in legal substance) satisfy the requirements of the particular provision but, when viewed in terms of their commercial and economic reality, make use of (or circumvent) the provision in a manner that is inconsistent with the purpose of that provision.
16. The intent and application of the temporary loss carry-back regime will be defeated by an arrangement that allows losses (and relief) to be claimed by businesses where, viewing the arrangement in terms of its commercial and economic reality, the required shareholding connection has not been or will not be maintained when comparing the loss year to the profit year.

17. IS 20/03 contains examples of situations that would be subject to s. GB 3B and GB 4 as follows:

- (a) Example 1 concerns a company that needs cash with an expected net loss in 2020-21 whose shareholders agree to sell a 60% shareholding to a third party but defer the sale to after year-end so that the net loss can be carried back – s. GB 3B applies;
- (b) Example 2 concerns the planned June 2020 sale of a wholly-owned group company that is postponed so that the net loss of another group company can be carried back and offset against the 2019-20 taxable profits of the company to be sold – s. GB 4 applies.

18. IS 20/03 also contains examples of situations that would not be subject to s. GB 3B and GB 4 as follows:

- (a) Example 3 concerns a company expected to make a net loss in 2020-21 which obtains funding from a bank on terms that include a deferral of a share transfer to after year-end if a guarantee has to be called up – s. GB 3B will not apply due to the commercial basis for the agreement;
- (b) Example 4 concerns a company whose shareholders agree to a funding arrangement under which a share transfer resulting in a breach in shareholding continuity would occur if the repayment obligations were breached (which is not anticipated) – s. GB 3B will not apply due to the commercial nature of the of the arrangement.



Arun David, Director,
DavidCo Limited