Inland Revenue
Te Tari Taake

March 2021

Questions and answers: Business continuity test (BCT)

Background

New Zealand's loss continuity rules are among the most stringent in the world. For losses to be carried forward, at least 49% continuity of ownership of the company is required to be maintained from when the loss arose until the time it is used. This test creates an impediment for businesses obtaining capital in order to innovate and grow because this can result in a breach of the 49% ownership continuity threshold. The Government wants to address this impediment, with a particular focus on start-ups and small-medium enterprises.

The intention was to release a discussion document canvassing various options for reform of the loss continuity rules. However, the arrival of COVID-19 changed priorities. The Government wanted to have the regime in place for the 2020–21 income year and on 14 April 2020, Cabinet made the decision to accelerate this work in response to the economic impacts of COVID-19 with application to the 2020–21 income year to allow businesses that may require recapitalisation due to the COVID-19 situation to take advantage of the new test. A model based on the Australian same or similar test could be developed and implemented quickly, so this model was chosen.

Since April 2020 officials have been working with a private sector reference group including a number of experienced tax practitioners as well as consulting with Chartered Accountants Australia and New Zealand, the Corporate Taxpayers Group and the members of the New Zealand Law Society Tax Law Committee to develop a business continuity test for New Zealand.

Legislation will be introduced in a supplementary order paper to the Taxation (Annual Rates for 2020–21, Feasibility Expenditure, and Remedial Matters) Bill at the Committee of the whole House stage in mid-March.

Questions and answers

Q1. What is a same or similar business test?

The same or similar business test is essentially a business continuity test which allows a company to carry its losses forward after a change in ownership as long as the underlying business continues. This test is intended to remove the impediment to capital raising while still preventing loss trading.

Q2. How much will loosening the loss continuity rules cost?

The fiscal cost is estimated to be $60 million forgone revenue per year.

Q3. The Australian same or similar test is still quite a restrictive test for businesses – especially due to changes made because of COVID-19, is it suitable for New Zealand?

In introducing a same or similar business test to New Zealand the Government wanted to encourage growth and innovation of firms whilst stopping the ability of firms to trade in tax losses, as officials worked through the Australian regime with external practitioners it became clear a "copy and paste" of that test to New Zealand would not meet the Government's goals for this change. Given that officials, in conjunction with the private sector, have designed a bespoke business continuity test (BCT) for New Zealand that is a hybrid of both the Australian and United Kingdom tests.

Q4. Does this mean the 49% continuity test has been replaced?

No, if a company continues to satisfy the existing 49% continuity rules they will not need to rely on the BCT.

Q5. How will the test work in practice?

The proposed BCT for New Zealand will allow losses to be carried forward unless there is a major change in the nature of the company's business activities, having regard to the assets used and other relevant factors. Relevant factors would include business processes, use of suppliers, markets supplied to, and the type of product or services supplied.

Not every change will be a major change. Any change in business activities (including use of assets) must be considered against the unchanged business activities (including use of assets) employed by the company to generate income to establish whether the change is "major". Generally, this would be question of scale (in other words, how significant is the change in the context of the operations of the entire company).

Q6. Will there be any exceptions to a firm that has had a major change to grow its business?

It is important that the New Zealand BCT recognises that companies change in order to innovate and grow. The UK uses its guidance material to achieve a similar result but is more specific as to exactly what type of changes are carved out. The proposed New Zealand BCT will adopt this approach but import it to legislation to provide greater certainty.

The proposed carve-outs are: changes to increase efficiency, increase scale, to keep pace with developing technology; or rationalisation of the company's product or service range by introducing new items produced using the same or largely the same assets of the company (excluding land but including fixtures to land) or of a kind relating to those already being produced or previously produced.

Q7. Why is land excluded when determining if the carve out for a change in product or service applies?

Excluding land (but not fixtures) is an integrity measure as it may be easy for a company to argue that it is using largely the same assets (if land is a large part of the assets) and this could allow a complete change of the business (for example, farming to a factory producing widgets).

Q8. Will all companies get to carry forward losses now?

No, some companies will fail the major change test and the carve outs will not apply, the result will be that the losses are forfeited.

Q9. How long do I have to maintain the BCT?

For most companies they will need to maintain the BCT until the end of the income year which is five years after the breach in continuity. The exceptions to this are companies with section DB 31(3) of the Income Tax Act 2007 deductions which relate to bad debt losses who will have to maintain the BCT until the losses are used.

Q10. Are all companies subject to the BCT?

No, mineral mining companies will not be subject to the BCT as those companies essentially have an existing business continuity test in the current regime which they can rely on.

Q11. Are the commonality rules changing also?

No, there is no change to the commonalty rules that require 66% commonality of ownership for companies to offset losses. So, if a company acquires another company that has losses it will not be able to offset preacquisition losses.

Q12. Can I just buy a company that isn't doing anything but holding losses and use those losses?

No, the BCT will not allow dormant companies to carry forward losses under the BCT.

Q13. Are there any limitations on what I can do with the company after purchase?

There will be a number of anti-avoidance provisions as part of the BCT to protect the tax base. Anti-income injection rules similar to those in Australia will be part of the test as well as rules to stop costs being transferred out of the loss company to other associated companies artificially increasing the income of the loss company.

Q14. Will all carry forward loss balances be subject to the BCT?

No, only losses incurred from the 2013–14 year onwards will be able to be carried forward under the BCT.

Q15. Will the continuity rules for imputation credits change at the same time?

The current rules for the carry forward of imputation credits will not be changing under the BCT. This was not part of the scope of the proposals.

Q16. Will Inland Revenue be putting out any guidance for taxpayers?

Yes, officials have been working with the Tax Counsel Office to develop some guidance which will be released in draft after the SOP is released. This has been worked on as part of the policy development process.