Inland Revenue
Te Tari Taake

TECHNICAL DECISION SUMMARY > ADJUDICATION

WHAKARĀPOPOTO WHAKATAU HANGARAU > WHAKAWĀ

Losses carried forward and debt remission income

Decision date | Rā o te Whakatau: 23 September 2022

Issue date | Rā Tuku: 26 April 2023

TDS 23/04

Subjects | Kaupapa

Losses carried forward; shareholder continuity breach; Assessability of debt remission income; Liability for shortfall penalty for taking an unacceptable tax position

Abbreviations | Whakapotonga

The abbreviations used in this document include:

CCS	Customer & Compliance Services, Inland Revenue
Commissioner	Commissioner of Inland Revenue
ITA 2007	Income Tax Act 2007
CSOP	Commissioner Statement of Position

Taxation laws | Ture tāke

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

Facts | Meka

1. The Taxpayer was a limited liability company that was placed in interim liquidation and receivers appointed.
2. The receivers returned debt remission income in the 2012 tax return for the Taxpayer.
3. A shareholding change in the Taxpayer took place in the 2012 tax year. A further shareholding change was alleged by Customer Compliance Services Inland Revenue (**CCS**) to have taken place in the 2013 tax year.
4. In the 2013 tax return the Taxpayer claimed an adjustment to reverse the debt remission income returned in the 2012 tax year.
5. In the Commissioner's Statement of Position (**CSOP**), CCS proposed to reduce the tax losses carried forward by the Taxpayer in the 2013 and 2014 tax years because of breaches in ownership continuity and proposed an unacceptable tax position shortfall penalty for each year. The reversal of the "debt remission income adjustment" in the 2013 tax year was also proposed in the CSOP as an alternative adjustment.

Issues | Take

6. The main issues considered in this dispute were:

- whether the Taxpayer satisfied the ownership continuity requirements to carry forward losses;
- whether the Taxpayer derived debt remission income for the 2012 tax year (and if not, whether the debt remission income returned for the 2012 tax year can be "reversed" by a negative "debt remission income adjustment" for the 2013 tax year); and
- whether the Taxpayer is liable for a shortfall penalty for taking an unacceptable tax position as a result of the Taxpayer having failed to satisfy the ownership continuity requirements to carry forward losses for each of the 2013 and 2014 tax years.

Decisions | Whakatau

7. TCO decided that:

- The Taxpayer had breached the continuity requirements for the 2012 tax year, but CCS had not proposed any adjustments for that period.
- The Taxpayer had derived debt remission income for the 2012 tax year, and the "debt remission income adjustment" for the 2013 tax year (by which the Taxpayer sought to "reverse" the debt remission income returned for the 2012 tax year) should be reversed as proposed by CCS.
- There is no relevant tax shortfall in either period on which to impose a shortfall penalty as the Taxpayer took the correct tax position in each of the 2013 and 2014 tax years.

Reasons for decisions | Pūnga o ngā whakatau

Issue 1 | Take tuatahi: Ownership continuity requirements to carry forward losses.

8. The issue was whether the Taxpayer had lost the ability to carry forward losses because the Taxpayer had failed to satisfy the ownership continuity requirements to do so.

9. CCS claimed that the Taxpayer had not satisfied the ownership continuity requirements to carry forward various losses because of shareholding changes in June 2012 and June 2013.

10. The Taxpayer maintained there had been no breach in its ownership continuity up to the end of the 2017 tax year, and that the Taxpayer was entitled to carry forward its losses for the respective income years.

11. Subpart IA governs the use of tax losses. If certain requirements are met, a company can carry forward a tax loss to a subsequent tax year to reduce the company's net income (if any) or to be added to the tax loss for the subsequent tax year. A tax loss carried forward for a preceding tax year may include tax loss components carried forward from earlier tax years. Tax loss components included in a tax loss must be used in the order in which they arose.

12. There is a continuity requirement to carry forward a tax loss in s IA 5. Ownership continuity is determined by identifying the minimum ownership interest held by an owner during the continuity period. Ownership interests are measured in terms of voting interests, and if a market value circumstance exists, market value interests. The ownership continuity requirement must be satisfied for each tax loss component that makes up a tax loss and for the continuity period applying to that component.

13. TCO concluded that the Taxpayer had satisfied the ownership continuity requirements to carry forward losses for the period from 1 July 2000 to 30 June 2011. This meant the Taxpayer was able to carry forward net losses for the 2001 to 2009 tax years in a loss balance for use against net income for the 2010 and 2011 tax years. The amount that can be so used is, in terms of the ordering rule, made up of tax loss components that are net losses for the 2001 and 2002 tax years, and part of the net loss for the 2003 tax year.

14. However, there was a shareholding change in the Taxpayer in June 2012. The result was that the Taxpayer had not satisfied the ownership continuity requirements to carry forward losses for the periods from 1 July 2002 to 30 June 2012, 1 July 2003 to 30 June 2012, and 1 July 2004 to 30 June 2012. This meant the Taxpayer could not carry forward the net loss that had not already been used for the 2003 tax year, and the net losses for the 2004 and 2005 tax years, in a loss balance for use against net income for the 2012 tax year. These losses had been "lost." However, CCS had not proposed any adjustments for the 2012 tax year (seemingly not having recognised the effect of the 30 June balance date, and incorrectly focussing on the 2013 tax year).

15. Subsequent to a second change in shareholding in the Taxpayer in June 2005, the Taxpayer had satisfied the ownership continuity requirements to carry forward tax losses for the period from 1 July 2005 to 30 June 2012. This meant the Taxpayer could

carry forward the net loss for each of the 2006 to 2009 tax years in a loss balance for use against the net income for the 2012 tax year.

16. There was no change in the shareholding in the Taxpayer in June 2013, applying s YC 9. This meant to the extent the Taxpayer had a net loss for the 2013 tax year, the Taxpayer was able to carry forward the net loss in a loss balance for use against net income for the 2014, 2015 and 2017 to 2020 tax years.

17. In summary, CCS had correctly identified that there was a shareholding change in the Taxpayer in June 2012, but there was no shareholding change in June 2013. As a result, the Taxpayer had failed to meet the ownership continuity requirements to carry forward losses for a number of continuity periods, but the effect was for the 2012 tax year (with 15 June 2012 within the Taxpayer's income year (1 July 2011 to 30 June 2012) that corresponds to the 2012 tax year) and CCS had not proposed any adjustments for the 2012 tax year.

Issue 2 | Take tuarua: Debt remission income

18. This issue was whether the Taxpayer had derived debt remission income for the 2012 tax year, and if not, whether the amount could be reversed for the 2013 tax year.

19. Under s CC 3, if a person who is a party to a financial arrangement is treated as deriving an amount of income under the financial arrangement under subpart EW (Financial arrangement rules), the amount is income of the person.

20. One of the purposes of the financial arrangement rules (FARs), under s EW 1(3)(c), is "to require a party to a financial arrangement to calculate a base price adjustment when the rights and obligations of the party under the arrangement cease." Under s EW 3(3), "a debt, including a debt that arises by law" and "a debt instrument" are financial arrangements. Under s EW 28, a party to a financial arrangement who must calculate a base price adjustment, as described in s EW 29 and EW 30, calculates it using the formula in s EW 31.

21. Under s EW 29(9) "a party to a financial arrangement must calculate a base price adjustment as at the date on which a party to the arrangement is discharged from making all remaining payments under the arrangement without fully adequate consideration". Section EW 46C applies in certain circumstances where a debt is remitted within an economic group, to the extent to which an amount of debt is remitted.

22. Under the general law and s 14(2) of the Receiverships Act 1993, the Joint Receivers and Managers (Receivers) of the property of the Taxpayer and the creditors had the power to discharge the Taxpayer's debt to the creditor.

23. The discharge was a bilateral discharge, with the Receivers acting for both the Taxpayer, as debtor, and the creditor. The Taxpayer's financial statements for the year ended 30 June 2012 evidence the agreement between the parties to the debt that the debt be discharged, with the amount forgiven recorded as "Debt Written Off" sundry revenue in the Taxpayer's statement of financial performance for the year ended 30 June 2012.

24. As the Receivers acted for both sides of the transaction, the discharge of the debt cannot be invalidated under s 16 of the Receiverships Act. In any event, the Taxpayer had not appeared to have sought to invalidate the transaction; for tax purposes, or more generally (instead merely seeking to reverse the tax effect through returning a negative "debt remission income adjustment" for the following tax year).

25. The tax consequences of the discharge of the debt (in that the Taxpayer's remaining debt to the creditor had been forgiven) was debt remission income to the Taxpayer of the amount remitted for the 2012 tax year, as correctly returned. Section EW 46C did not apply to prevent this outcome (so the taxpayer's "reversal" of the debt remission income in 2013 is incorrect, as argued by CCS).

Issue 3 | Take tuatoru: Unacceptable tax position shortfall penalty

26. The Taxpayer's loss balance to carry forward for each of the 2013 and 2014 tax years was unaffected by the Taxpayer's failure to satisfy the ownership continuity requirements to carry forward losses. There was no relevant tax shortfall in either period on which to impose a shortfall penalty.

27. The Taxpayer's tax position as to the availability of a tax loss component or loss balance to carry forward for the 2013 tax year was incorrect because of the correctness of the proposed adjustment to reverse the Taxpayer's "debt remission income adjustment" for the 2013 tax year. However, no shortfall penalty had been pursued by CCS for this adjustment.