Tax Loss Carry Back

The Aussies have been doing it for years.

One of the tax changes announced because of COVID 19 will allow tax losses to be carried back in certain circumstances. This change will let a company obtain a refund of tax paid in a previous year by applying a current year tax loss to the earlier year. Other countries, such as Australia and Canada have had similar rules for some time. The change will be very welcome for many local businesses that now expect to see a lot of red ink resulting from COVID -19 disruptions.

The new rules initially apply only to tax losses incurred in the 2020 and 2021 years, because they have been rushed through Parliament to support local business recovery, post-lockdown. We hope to see legislation making these rules a permanent part of our tax landscape, but that may not eventuate.

The rules will allow immediate refunds where losses are anticipated, with a square up once the relevant income tax returns are filed. The regime is elective, meaning companies don't have to carry losses back if they do not want to. They may choose to carry the loss forward, as they would normally have done.

Like most tax rules, the devil is in the detail. So, we've highlighted some snags below to check before rushing in.

Now, for tomorrow

1. Salaries and overdrawn current accounts

For most taxpayers, the 2020 financial year was nearly over when this scheme was announced. Certain decisions may have already been made, such as the drawings taken with the expectation a shareholder's salary would be paid to offset those drawings. If 2021 tax losses are carried back, the 2020 profit will be reduced or eliminated. If there is no 2020 profit and no shareholder salary is paid, the shareholder may be left with an overdrawn current account, and the new rules contain no corrective mechanism.

2. Dividends and imputation credit account

For companies, the normal rules limiting income tax refunds to the level of available imputation credits still apply. If 2021 tax losses can be carried back, and the company expects to get a refund of the 2020 provisional tax paid, it will still need sufficient imputation credits to allow a tax refund to be released.

3. Use of money interest risk

Under this scheme, you don't need to wait for the tax year to be completed. You can estimate what your 2021 loss will be now and use that to get a tax refund straight away. But the risk with estimates is that there is no safe harbour to protect against use of money interest being charged. Consequently, if you over-estimate the tax loss and therefore under-estimate your tax, you can expect to incur use of money interest. Also, there is also no ability to use the COVID-19 interest remission concessions on the underpayment. This puts taxpayers into a delicate balance situation of trying to maximise the much-needed cash injection of a tax refund now against potential future interest charges.

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4. Careful taking on new shareholders

If you are a company, don't assume you can carry back a tax loss without checking the company's shareholder continuity. These rules apply equally for losses that are carried forward and for losses that are carried back. While there are going to be new rules loosening rules for carrying forward losses those will only apply to the 2021 year onwards.

5. Non-refundable credits

There needs to be sufficient taxable income left in the company after losses carried back to cover any non-refundable credits (e.g. foreign taxes paid). Otherwise these credits will be wasted and a portion of the carried back losses will have been used unnecessarily.

6. Wholly owned group companies

Where a company with losses is part of a wholly owned group of companies, its losses first need to be offset against any taxable income of companies within that wholly owned group before they can be carried back to the prior income year. The income tax position of each group company within a wholly owned group needs to be considered prior to any election to carry back a loss.

Conclusions

The carry-back scheme is a welcome addition to New Zealand's tax system. We hope it will allow some taxpayers to receive a much-needed cash injection into their business when it needed it the most, and we hope it becomes a permanent fixture.

We always recommend that you obtain advice from your accountant before committing to a tax position.
