CPA Australia Ltd
ABN 64 008 392 452
Level 20, 28 Freshwater Place
Southbank VIC 3006 Australia
GPO Box 2820 Melbourne
VIC 3001 Australia
T 1300 737 373
Outside Aust +613 9606 9677
cpaaustralia.com.au

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Inland Revenue Department
New Zealand

By email: **Public.Consultation@ird.govt.nz**

Your reference: PUB00376

Dear Sir or Madam,

Loss carry-forward – continuity of business activities

CPA Australia represents the diverse interests of more than 168,000 members, including over 2,700 members in New Zealand, working in over 100 countries and regions supported by 19 offices around the world. We make this submission on behalf of our members and in the broader public interest.

The Inland Revenue's (**IRD**) interpretation statement **PUB00376: Loss carry-forward - continuity of business activities** (**the interpretation statement**) seeks CPA Australia's comments on its guidance on how the main aspects of the business continuity test in s IB 3 apply.

All legislative references are to the *Income Tax Act 2007* (ITA 2007) unless otherwise indicated.

Overall, we find the interpretation statement to be practical and clear. We raise the following two points for your consideration.

Mainly the same

We do not agree with the Commissioner's interpretation that, to satisfy both limbs of s IB 3(5)(d), the interpretation of "mainly" and "closely connected" should numerically equate to approximately 75 per cent (paragraphs 1 and 84). We believe that preserving flexibility and using an approach that can accommodate particular facts and circumstances is appropriate. This is due to the wide range of possible outcomes and the potential unintended consequences of imposing a specific numerical requirement.

We submit that:

- We are not aware of legislative or judicial support, nor is there evidence presented, to justify the interpretation that "mainly the same" necessarily translates to a quantitative assessment and numerically equates to approximately 75 per cent in situations such as s IB 3(5)(d)
- To assign a numerical percentage to "mainly the same" in valuing assets is unnecessarily restrictive and introduces a quantitative threshold that may not be appropriate in particular situations.

We note that the interpretation of "mainly the same" in s IB 3(5)(d) does not require the assignment of a numerical value. Therefore, we suggest the interpretation of s IB 3(5)(d) should consider whether the same key assets, both physical and intangible assets, that are used in the current business to generate assessable income, were also used in the company's former business to generate income.

Should the 75 per cent threshold be maintained, we suggest the inclusion of a statement indicating that the Commissioner will exercise discretion in relation to the 75 per cent threshold where it would be reasonable to conclude that the "same, or mainly the same" assets continue to be used but the threshold of approximately 75 per cent is not satisfied.

Replacement value

In Example 5 – Diversifying a "bricks and mortar" business (**Example 5**), the Commissioner uses "replacement value, to prevent distortion", in determining whether the company satisfies s IB 3(5)(d), where the "same, or mainly the same" assets are used to produce or provide the new type of product or service.

As this is the only reference to asset valuation methods in the interpretation statement, this may be taken to mean that replacement value is the only method that can be used by taxpayers. We submit that:

- Financial accounts do not record assets at replacement value and a range of valuation methods are available
- A separate valuation to ascertain replacement value imposes an additional time and cost burden to the company
- There is no legislative requirement to use replacement value to determine whether s IB 3(5)(d) is satisfied.

If the Commissioner intends to permit the choice of asset valuation method, we suggest that a paragraph is included which states that taxpayers can choose the asset valuation method that provides an accurate valuation of their key business assets (e.g. historical cost, impaired value, fair value, replacement value).

With respect to the words "to prevent distortion" contained in Example 5, we note that the use of replacement value may in fact create distortions for certain assets. The reliability of the measurement of replacement value depends upon the nature of the asset. For some assets such as inventory, there is a well-established market and replacement value can be measured reliably. In other cases, such as non-current assets, replacement value may have to be estimated and its measurement therefore may not be as reliable. However, we note in Example 5, non-current assets were measured at replacement value in determining that s IB 3(5)(d) was satisfied which may not be appropriate given the low likelihood of available market data for valuation purposes and may be less reliable than historical cost.

If it is argued that a company is going to continue with its current business operations in the foreseeable future, then the current replacement value of assets may 'provide data for the evaluation of the existing mode of production'[1]. Current replacement cost data may be useful in evaluating the strength of the entity as a continuing concern and the use of current replacement cost may be justified[2] for valuing such assets.

Based on the above, we submit that Example 5 should replace the words:

> "By value, approximately 75% of the assets of the business have remained the same or similar through the change (using replacement value to prevent distortions)."

with:

> "By value, approximately 75% of the assets of the business have remained the same or similar through the change. Replacement value was used as it was found to be the most accurate valuation method for the assets utilised in that company."

If you have any queries about this submission, contact Rick Jones, Country Head, New Zealand on +64 21 190 1039 or **rick.jones@cpaaustralia.com.au** or Elinor Kasapidis, Senior Manager Tax Policy on +61 3 9606 9666 or **elinor.kasapidis@cpaaustralia.com.au**.

Yours sincerely,

Dr Gary Pflugrath
Executive General Manager,
Policy and Advocacy

Mr Rick Jones
Country Head,
New Zealand

[1] R. Ma, 'Current Value Accounting - Promise and Reality', in *Bulletin No. 15: Accounting for Price and Price Level Changes (A Symposium)*, Australian Society of Certified Practising Accountants, Melbourne, 1974, p 38.

[2] Scott Henderson and Graham Peirson, Issues in Financial Accounting, 7th Edition, Addison Wesley Longman Australia, South Melbourne, 1995, p 83