
Income tax – Losses

Generally, where a taxpayer's annual allowable deductions exceed annual gross income for an income year, the taxpayer has a net loss.

Loss entitlement

A taxpayer with a net loss for an income year is entitled to carry that loss forward to the immediately succeeding income year as an available net loss.

The taxpayer may then deduct it from, or set it off against, the net income for that immediately succeeding income year.

There is no time limit on when a net loss can be carried forward, but a net loss cannot be carried back to a previous year.

Where net losses are incurred in 2 or more income years and carried forward, they are deducted or set off in the order in which they arose.

Losses in a partnership

Losses incurred in a partnership, except for special partnerships, are allocated to the partners who then include that share of the loss in their own personal income tax returns

Losses in a companies

Where a company has brought forward losses from a prior year, or is a member of a group against whose profits it wishes to offset its losses, the statutory tests for the preservation and transfer of those losses must be satisfied.

Companies with 66% shareholding commonality as to voting interests and, if applicable, market value interests, may be treated as a 'group of companies' for the purposes of loss offsets and subvention payments.

Use of losses to pay shortfall penalties

A taxpayer can elect to use a net loss to pay a shortfall penalty.

The taxpayer can do this if the net loss is available to be offset against the taxpayer's net income in the income year the shortfall penalty is imposed, provided the taxpayer notifies Inland Revenue of the election by the due date for payment of the penalty.

The losses used may be either current year losses or losses carried forward from a previous year. There is no requirement that the losses must have been incurred since the introduction of the shortfall penalty rules.

If a taxpayer elects to use current year losses, the losses are deemed to be offset at the time the election is made.

The election to use a use a net loss to pay a shortfall penalty may be in either written or verbal form. 'Income year' includes any part of a year taken into account for the purposes of carrying forward or grouping company losses.

A wholly-owned group of companies may elect to use a loss incurred by one company in the group to pay a shortfall penalty imposed on another company in the group.

The amount by which the penalty is reduced is the amount of the loss multiplied by the taxpayer's lowest marginal tax rate. That is:

Each dollar of net loss used to pay a shortfall penalty counts as an amount equal to:

$$\$1 \times \text{tax rate}$$

'Tax rate' means the rate of tax, or the lowest marginal rate of tax, that would apply to the taxpayer during the return period to which the shortfall penalty relates. For companies, the tax rate is 33%. For individuals, the tax rate is the lowest marginal tax rate.

Example: In the case of a company, a loss of \$1,000 would be sufficient to pay a penalty of \$330 ($\$1,000 \times 33\%$).

Once a net loss has been used to pay a shortfall penalty, that loss is no longer available for any other use.

Inland Revenue's approach

A taxpayer who has no losses carried forward from prior years, or has insufficient losses to eliminate both tax and penalty, but who expects to have losses in the current year, can elect to use those losses, even though the final loss for that current year has not been established.

If the taxpayer does incur sufficient losses for that current income tax year, the shortfall penalties are deemed to have been paid by the due date.

However, if at the end of the income year the taxpayer does not incur sufficient losses, late payment penalties and interest will be imposed on the tax shortfall penalty that should have been absorbed by the losses.

Losses can only be used to offset income tax penalties

Penalties which relate to anything other than income tax are not assessable income items and the losses cannot be offset against them. Losses are not available to be offset, for example, against shortfall penalties on PAYE, as this is not income tax to the employer.

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- ✦ Before making any financial decisions.
- ✦ To assist you in meeting the necessary legal or financial requirements.
- ✦ If you consider that any of the issues contained in this fact sheet may affect you.

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