

Worked example

## Single waiver rule – disregarding a reduction to modified market value caused by an injection of capital from a value donor

**Description** An integrity rule prevents the inflation of modified market value in respect of an injection of capital from a value donor to a real loss-maker. This example shows how the single waiver rule<sup>1</sup> ignores the effect of this integrity rule.

### Note

For more information about:

- the integrity rule → 'Calculating an available fraction – losses transferred for the first time where there has been a pre-joining injection of capital', C3-4-120
- applying the value donor concession → 'Adding to modified market value to reflect loss transferability', C3-4-210
- the group waiver rule → 'Group waiver rule – disregarding reductions to modified market value caused by intragroup injections of capital', C3-4-260

**Commentary** The single waiver rule is only relevant when applying the value donor concession.<sup>2</sup>

Broadly, the value donor concession enables the available fraction for a bundle of losses to be increased if the value donor could have received a loss from the real loss-maker under the wholly-owned company group loss transfer rules in Division 170 of the *Income Tax Assessment Act 1997* (ITAA 1997).

The increase to an available fraction provided by the value donor concession can be affected by the integrity rule. The integrity rule operates to reduce the modified market value of an entity. The reduction amount essentially represents the increase in the value of the entity as a consequence of injections of capital<sup>3</sup> or non-arm's length transactions involving the entity in the four years<sup>4</sup> before it joins the consolidated group. → subsections 707-325(2) to (5), ITAA 1997

In certain circumstances it is appropriate to 'waive' the consequences of certain inflationary events occurring between related entities. The single waiver rule

<sup>1</sup> Section 707-326, *Income Tax (Transitional Provisions) Act 1997* (IT(TP)A).

<sup>2</sup> The value donor concession is contained in Subdivision 707-C, IT(TP)A.

<sup>3</sup> Taxation Ruling 2004/9 provides the ATO view on the meaning of the expression 'injection of capital'.

<sup>4</sup> The integrity rule does not apply to events that occur before 9 December 2000.

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disregards the effect of the integrity rule in respect of injections and transactions involving the real loss-maker and a value donor. It may apply to groups unable to satisfy the conditions of the group waiver rule. → section 707-328A, IT(TP)A

The single waiver rule applies if either of these events occurred before the joining time:

- an injection of capital directly into the real loss-maker by the value donor, or
- a non-arm's length transaction involving only the real loss-maker and the value donor.

Where these conditions are met, the modified market value of the real loss-maker is not adjusted to exclude an increase in value caused by the event.

However, the single waiver rule has no application if the integrity rule has applied to the value donor in respect of events involving the value donor and an entity that is not the real loss-maker → subsection 707-326(5), IT(TP)A. This ensures a value donor cannot be used as a conduit to direct value from another entity to the real loss-maker, thereby avoiding the effect of the integrity rule.

## Example

**Facts** HCo and its subsidiaries ACo and BCo have constituted a wholly-owned group for a number of years. On 1 July 2003, HCo chooses to form a consolidated group.

BCo (the real loss-maker) transfers a loss at the joining time. HCo and ACo are able to donate value to BCo for the purpose of determining the available fraction for bundle BCo.

An injection of capital of \$100 was made by HCo into BCo on 1 December 2002.

An injection of capital<sup>5</sup> of \$50, used to acquire trading stock, was made by XCo, an entity outside the consolidated group, into ACo on 1 January 2003.

An injection of capital of \$200 was made by ACo into BCo on 1 March 2003.

Assume for the purposes of subsection 707-325(3) of the ITAA 1997 that the reduction amount equals the amount of each injection of capital.

HCo, ACo and BCo satisfy all the requirements in relation to the value donor concession.

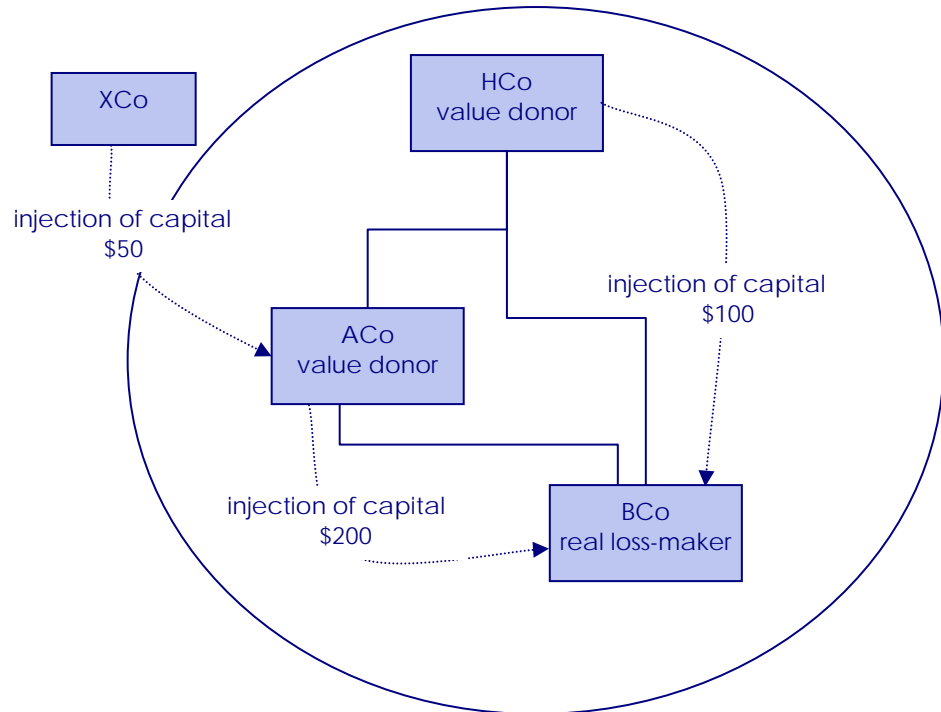
HCo chooses 100% of the modified market values of HCo and ACo to be donated for the purposes of working out the available fraction for BCo's bundle of losses.

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<sup>5</sup> A payment for non-share equity.

These facts are represented in figure 1.

Figure 1: HCo and subsidiary members



The adjusted market value of the consolidated group at the initial transfer time is \$1,650.

Modified market values ascertained as at the joining time are shown in table 1.

Table 1: Modified market values at 1 July 2003

Entity	Modified market value (subsection 707-325(1), ITAA 1997)	'Reduced' modified market value (subsection 707-325(2), ITAA 1997)
HCo	\$100	\$100*
ACo	\$950	\$900
BCo	\$600	\$300**

\* The integrity rule does not apply in respect of HCo.

\*\* The reduction amount for the purposes of subsection 707-325(2) of the ITAA 1997 is the collective increase in market value that occurred as a result of the injections.

## Calculation

As a result of the injection of capital from XCo the group is unable to meet the conditions for applying the group waiver rule. → 'Group waiver rule – disregarding reductions to modified market value caused by intragroup injections of capital', C3-4-260

Applying the value donor concession, ignoring the application of the single waiver rule, the available fraction for BCo's bundle of losses would be:

$$\frac{300 + 900 + 100}{1,650} = 0.788$$

### Application of the single waiver rule

The single waiver rule can be applied to the injection of capital from HCo to BCo. BCo's modified market value is worked out disregarding the effect of subsection 707-325(2) of the ITAA 1997 in respect of the injection of capital from HCo → subsection 707-326(2) of the IT(TP)A. The modified market value of BCo can therefore include the \$100 of value injected by HCo on 1 December 2002.

The single waiver rule has no application in respect of the injection of capital from ACo because ACo was required to reduce its modified market value to take into account the injection of capital from XCo.

Applying the value donor concession, including the application of the single waiver rule, the available fraction for BCo's bundle of losses would be:

$$\frac{400 + 900 + 100}{1,650} = 0.848$$

## References

*Income Tax Assessment Act 1997:*

- sections 707-320, 707-325

*Income Tax (Transitional Provisions) Act 1997:*

- sections 707-325, 707-326, 707-329

### Revision history

Section C3-4-270 first published 27 January 2005.

### Proposed changes to consolidation

Proposed changes to consolidation announced by the Government are not incorporated into the *Consolidation reference manual* until they become law. In the interim, information about such changes can be viewed at:

- <http://assistant.treasurer.gov.au> (Assistant Treasurer's press releases)
- [www.treasury.gov.au](http://www.treasury.gov.au) (Treasury papers on refinements to the consolidation regime).