Adjusting the available fraction – post-consolidation events that increase market value of group

Key points

This section explains how an adjustment is made to the existing available fraction for a bundle of losses under item 4 in the table in subsection 707-320(2) of the ITAA 1997. It focuses on how the adjustment applies to an existing consolidated group or MEC group.

Broadly, an adjustment to existing available fractions is required if:

- there is an event as described in subsection 707-325(4), and
- the group's market value increases as a result of the event.

Background

The available fraction is the core component of the rules for the utilisation of transferred losses by consolidated groups. It establishes the limit for the utilisation of transferred losses in a bundle for an income year. The rationale is that the rate of loss usage should be restricted to approximate the rate that would have been available to the entity from which the loss was transferred had it remained a single entity outside the consolidated group.

Available fractions are adjusted to ensure they continue to approximate the proportion of the group's income that can be said to be generated by the relevant loss entity. Adjusting event 4 applies where the group's market value has increased as a result of an injection of capital or a non-arm's length transaction involving entities external to the group. Existing available fractions are multiplied by the factor contained in item 4 in the table in subsection 707-320(2).

Note

For examples of the application of adjusting event 4 see:

- 'Adjusting available fraction – post-consolidation injection of capital into subsidiary member', C3-4-341
- 'Adjusting available fraction – post-consolidation injection of capital where head company issues shares in scrip for scrip merger', C3-4-342.

These worked examples show the procedure for adjusting available fractions. They are not intended to provide guidance on what constitutes an event or how valuations should be undertaken.

When are available fractions adjusted?

Under adjusting event 4, the available fraction for a bundle of losses is adjusted if the market value of the company[1] to which the losses were most recently transferred is increased as a result of either of these events:

- an injection of capital[2] into the group or an associate of the group, or
- a non-arm's length transaction that involves the group or an associate of the group.

Certain injections of capital, as described in subsection 707-325(5), are disregarded. Broadly, they are injections into a listed public company made through a dividend reinvestment scheme and injections under a qualifying employee share acquisition scheme.

Adjustment factor

Under item 4 in the table in subsection 707-320(2), each available fraction is reduced just after the event by multiplying it by the following factor:

$$\frac{\text{Market value of the company just before the event}}{\text{Market value of the company just before the event} + \text{Amount of the increase}}$$

In the case of an existing consolidated group, the reference to an increase in the market value of the company means an increase in the market value of the entire consolidated group, as a result of the operation of the single entity rule.[3]

As this section focuses on the application of adjusting event 4 where the transferee is a head company, the term 'market value of the group' is used hereafter for ease of understanding.

Market value of the group just before the event

In determining the market value of the group just before the event, the Tax Office would expect a taxpayer to be able to clearly demonstrate how this valuation has been calculated, given the particular facts of each case. The Tax Office has published guidelines on undertaking valuations required by consolidation law. → 'Market valuation guidelines', C4-1

Amount of the increase

In determining the amount of the increase in the market value of the group attributable to the event, taxpayers need to ensure that any impact from other transactions or events that occur around the time of the event are not taken into account.

A method of establishing the amount of the increase in market value is to obtain two valuations. The first would be undertaken as at the time just after

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[1] This will generally be the head company of a consolidated group or MEC group. In a situation where the consolidated group or MEC group has ceased to exist, this will be the former head company of that group.

[2] Taxation Ruling TR 2004/9 provides the Tax Office view on the meaning of the expression 'injection of capital'.

[3] For MEC groups, ATO Interpretative Decision 2004/961 states that references to the 'market value of the company' in item 4 in the table in subsection 707-320(2) are references to the market value of the entire MEC group.

the event occurs. The second valuation would be undertaken as at that time on the assumption the event did not take place. This second valuation establishes what the market value would have been had the event not occurred. The difference between these two valuations establishes the amount of the increase.

Using this approach, actual and hypothetical market valuations need to be undertaken for each event.

Calculating the reduced available fractions

There are four steps to determining the reduced available fraction for each bundle of losses in a situation where adjusting event 4 applies (table 1).

Table 1: Steps to determining the reduced available fraction

Step	Description	Determination or calculation	Short cut*
1	Market value before event	Determine market value of consolidated group or MEC group just before the event	Yes
2	Amount of the increase	Determine increase in group market value attributable to the injection of capital or non-arm's length transaction	Yes
3	Factor	Divide the step 1 amount by the sum of the step 1 and step 2 amounts	–
4	Adjust available fraction	Multiply the available fraction for the bundle of losses by the step 3 factor.	–
		Repeat for each bundle of losses.	

*Short cut options apply only in certain circumstances.

Item 4 short cut option

There may be substantial costs in obtaining the valuations required to accurately calculate the factor (identified at step 3).

In recognition of these costs, the Commissioner of Taxation has provided a short cut option for adjusting event 4 that removes the need to obtain additional valuations.

All groups other than certain listed public groups

Amount of the increase

This short cut option is only available where the event is a cash injection. In this situation, the Tax Office will accept the actual dollar amount of the cash injected into the group as the amount of the increase (the step 2 amount).

This short cut option is not available where the event is a non-cash injection or a non-arm's length transaction. In these situations there is still a requirement to obtain the necessary valuations.

Certain listed public groups

The following short cut option applies where all the shares in the head company are ordinary shares and listed on the Australian Stock Exchange (ASX).

If this short cut option is chosen, both elements of the short cut must be adopted where applicable.

(1) Market value just before the event

The Tax Office will accept, as the market value of the consolidated group just before the event (the step 1 amount), the amount obtained by multiplying the ASX share price at that time by the number of shares.

This short cut option is provided in recognition that the group's market value just before the event is contained in both the numerator and denominator of the formula for working out the factor at step 3 and because it can provide significant compliance savings.

(2) Amount of the increase

(a) Cash injections

Where the event is a cash injection the Tax Office will accept the actual dollar amount of the cash injected into the group as the amount of the increase (the step 2 amount).

(b) Scrip for scrip mergers or takeovers

Where the event is a scrip for scrip merger or takeover that is effected by way of a court ordered scheme of arrangement, the Tax Office will accept the listed ASX share price at the end of the merger implementation date multiplied by the amount of new shares issued to effect the merger as the amount of the increase. → 'Adjusting available fraction – post-consolidation injection of capital where head company issues shares in scrip for scrip merger', C3-4-342.

Example

Applying the short cut option

The head company of a consolidated group has a bundle of losses. The head company issues additional shares on the share market. The share subscription raises $70 million of additional share capital.

Just prior to this event:

- the available fraction for the bundle of losses was 0.350
- the issued capital of the head company comprised 100 million ordinary shares, all of which were listed on the ASX, and
- the ASX share price was $9.30.

Applying the short cut option:

1. Market value just before the event is $930 million (100 million × $9.30).

2. Amount of the increase is $70 million.

3. The factor is:

$$\frac{930 \text{ million}}{930 \text{ million} + 70 \text{ million}} = 0.93$$

4. Adjusted available fraction for the bundle of losses is determined as follows:

$$0.93 \times 0.350 = 0.326$$

The available fraction is therefore reduced from 0.350 to 0.326 just after the event.

Revision history

Section C3-4-340 first published 2 December 2002 as a worked example.

On 6 April 2006 it was withdrawn and replaced by:

- this version of C3-4-340, which explains adjusting event 4
- the related worked examples C3-4-341 and C3-4-342.

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** (Treasury papers on refinements to the consolidation regime).