Worked example

Determining the start of a test company's loss year to assess continuity of ownership of the focal company in a MEC group (special conversion event)

Description

This example shows how to determine the start of the test company's loss year when the loss is transferred to the head company of a consolidated group because the same business test is met and when a MEC group is subsequently created from the consolidated group. This is known as a special conversion event.

Determining the start of the test company's loss year is part of the process of assessing the continuity of ownership of the group's focal company (the company that seeks to utilise the loss). → 'MEC groups and losses – determining whether the focal company satisfies the continuity of ownership test', C10-2-325

Commentary

In recognition of the special characteristics of MEC groups, Subdivision 719-F of the *Income Tax Assessment Act 1997* (ITAA 1997) modifies the rules about transferring and utilising losses within those groups.[1]

In order to apply the continuity of ownership test (COT) to the test company, it is necessary to assume that the test company made the loss, even if it actually did not (e.g. because the test company is also the top company).

The COT is applied to the test company for its ownership test period – the period from the start of the test company's loss year until the end of the income year in which the focal company seeks to utilise the loss.

The tables in section 719-270 are used to determine the start of the test company's loss year based on the identity of the test company and how the loss was made.

[1] Subdivision 719-F does not apply if the MEC group has converted to a consolidated group during the ownership test period, where the conversion took place:

- on or after 27 October 2006, or
- before 27 October 2006 and a choice in writing is made within the prescribed time for Subdivision 719-BA to apply from 1 July 2002.

→ section 719-140, ITAA 1997; paragraphs 5.92, 5.105 and 5.106, Explanatory Memorandum to Tax Laws Amendment (2010 Measures No. 1) Bill 2010

Example

Facts

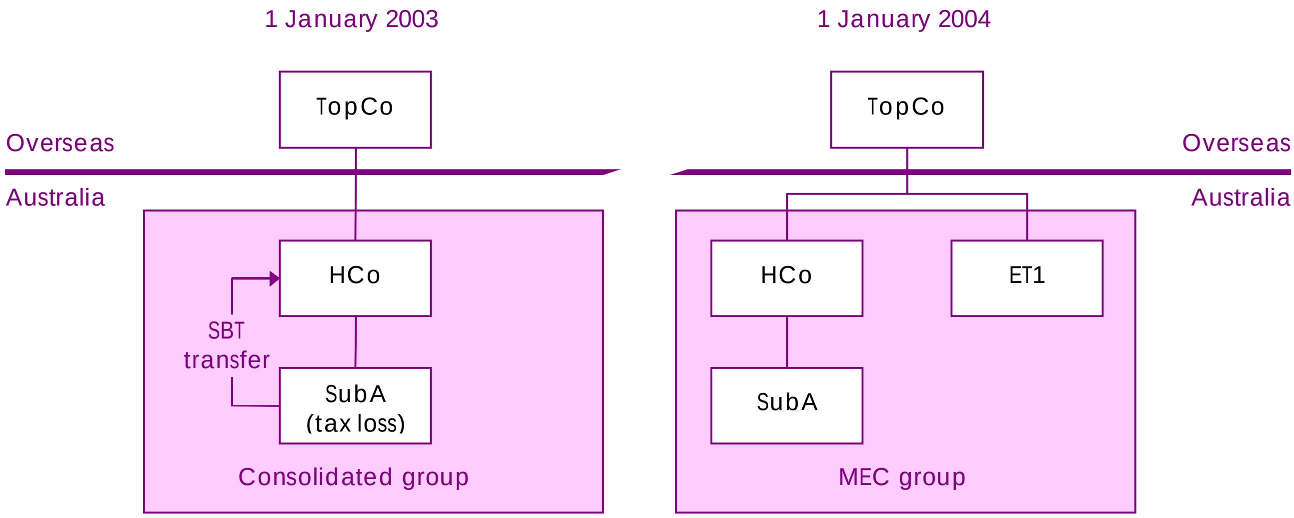
HCo is a wholly-owned subsidiary of TopCo (a non-resident company). HCo forms a consolidated group with SubA as its subsidiary member on 1 January 2003. A tax loss made by SubA in an earlier income year is transferred to HCo because the same business test is satisfied.

On 1 January 2004, TopCo acquires another eligible tier-1 company, ET1, and HCo makes the choice in writing under paragraph 719-40(1)(e) of the ITAA 1997 to create a MEC group from its consolidated group as a result of ET1 becoming an eligible tier-1 company of TopCo (a special conversion event). HCo, the head company group notifies the Commissioner of this choice in the approved form within the prescribed period.

→ 'MEC groups – notices to be given to the Commissioner', C10-1-110; 'Choice on formation, special conversion events and acquisition of new eligible tier-1 companies', C10-2-110

HCo, the focal company, seeks to utilise the loss in the income year ending 30 June 2004. At all times since the MEC group formed, HCo has been its head company.

Figure 1: Sequence of events



Calculation

The test company is HCo. → subsection 719-265(3), table item 2; 'MEC groups and losses – determining whether the focal company satisfies the continuity of ownership test', C10-2-325; 'Identifying the test company to determine continuity of ownership of the focal company in a MEC group (COT transfer of losses)', C10-2-330; 'Identifying the test company to determine continuity of ownership of the focal company in a MEC group (SBT satisfied)', C10-2-340

The table in subsection 719-270(2) applies as the test company is also the focal company.

Item 2 in the table applies as HCo, the test company, is considered to have made the loss because it was transferred to HCo under Subdivision 707-A in a transfer other than a COT transfer → subsection 707-210(1A).

Column 2 of item 2 in the table states that the start of the income year in which the test company is assumed to have made the loss is the time of the transfer.

Therefore, for the purpose of applying the COT, the income year in which HCo (the test company) is assumed to have made the loss starts on 1 January 2003, i.e. at the time of the transfer.

References

Income Tax Assessment Act 1997, section 165-12

Income Tax Assessment Act 1997, Subdivision 719-F, subsection 707-210(1A); as amended by *New Business Tax System (Consolidation and Other Measures) Act 2003* (No. 16 of 2003), Schedule 13

Explanatory Memorandum to the New Business Tax System (Consolidation and Other Measures) Bill (No. 2) 2002, Chapter 3

Income Tax Assessment Act 1997, Subdivision 719-BA; as inserted by *Tax Laws Amendment (2010 Measures No. 1) Act 2010* (No. 56 of 2010), Schedule 5, Part 2

Explanatory Memorandum to Tax Laws Amendment (2010 Measures No. 1) Bill 2010, paragraphs 5.65 – 5.110

Revision history

Section C10-2-360 first published (excluding drafts) 2 December 2002 and updated 28 May 2003.

Further revisions are described below.

Date	Amendment	Reason
6.5.11	Revisions to reflect changes to group conversion provisions.	Legislative amendments.