Worked example

Including value donor's losses in real loss-maker's bundle

Description

A loss entity (the 'real loss-maker'), in calculating its available fraction, may add to its modified market value the modified market value of another company (the 'value donor'). Certain losses from the value donor are also able to be transferred notionally to the real loss-maker's bundle. This enables those losses to be utilised using the available fraction for the real loss-maker.

This example shows how to treat a value donor's losses as being included in a real loss-maker's bundle, where the value donor's modified market value is nil.

Note

For more information about:

- loss bundles and calculating the available fraction → 'Treatment of losses', C3-1; 'Consolidation loss provisions', C3-2-110 (high-level worked example)
- working out modified market value → 'Modified market value of a single joining entity', C3-4-110 (worked example)

Commentary

Subdivision 707-C of the *Income Tax (Transitional Provisions) Act 1997* sets out the operation of the value donor concession. In broad terms:

- For a company to be a value donor, it must be a company to which the real loss-maker could have transferred, under the group loss transfer rules in Division 170 of the *Income Tax Assessment Act 1997*, at least one of the losses in its bundle.
- To be eligible for the concession, both the real loss-maker and the value donor must be companies that join the group when it first consolidates, and the group must consolidate during the transitional period (that is, 1 July 2002 to 30 June 2004).

The head company may also treat one or more of the value donor's losses as if it was included in the real loss-maker's bundle for the purpose of determining the amount of the losses that can be utilised by the group in any given income year. Broadly, losses can be treated in this way only if they could be transferred from the value donor to the real loss-maker, and to any of the real loss-maker's other value donors, under the group loss transfer rules.

Example

Facts

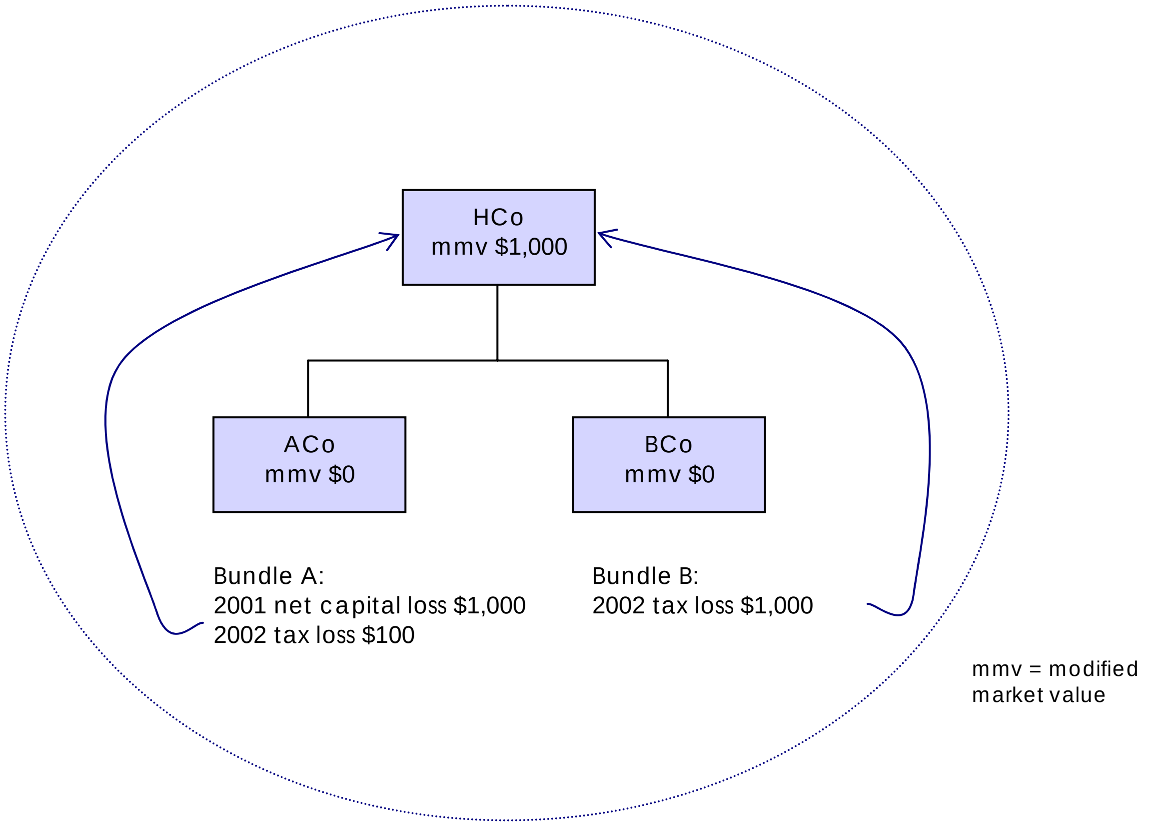
HCo, ACo and BCo have constituted a wholly-owned group for a number of years. There have been no changes in HCo's ownership or control. The group consolidates on 1 July 2002 and ACo's and BCo's losses (as set out in figure 1) are transferred to HCo, the head company of the group, under Subdivision 707-A.

HCo chooses to:

- add to the modified market value of ACo by using an amount of HCo's and BCo's modified market value for the purposes of working out the available fraction for the bundle of losses transferred from ACo, and
- treat the loss transferred from BCo as being included in the bundle of losses transferred from ACo for the purpose of determining its rate of utilisation.

The market value of the consolidated group at the joining time, ignoring losses and assuming a franking account balance of nil, is $1,000.

Figure 1: Transfer of losses at time of consolidation (1 July 2002)



Calculation

Adding to ACo's modified market value an amount of HCo's modified market value

For HCo to be able to add to ACo's modified market value, certain conditions set out in subsections 707-325(1) and (2) must be met:

- The bundle of losses transferred from ACo must contain either a tax loss or a net capital loss and the utilisation of the loss is not affected by section 707-350[1].
- HCo, assuming it had made the loss, could have transferred it to itself under Subdivision 707-A.
- ACo could have transferred the loss to HCo under Subdivision 170-A or 170-B for an income year consisting of the trial year.

Note

Income year and trial year

Throughout this worked example, the income year is treated as consisting of the trial year. However, if the income year in which the loss is made starts after the commencement of the trial year, the income year is a shorter period.

→ subsection 707-328(2)

The amount that is added to ACo's modified market value is worked out in accordance with the formula contained in subsection 707-325(3):

$$\text{HCo's modified market value at initial transfer time} \times \text{Percentage chosen by HCo} \times \frac{\text{Total of ACo's Division 170 losses in bundle}}{\text{Total of ACo's non-foreign losses in bundle}}$$

'Total of ACo's Division 170 losses in bundle' are those losses that meet all of the conditions stated above. Both the 2001 net capital loss of $1,000 and the 2002 tax loss of $100 meet all of the conditions.

'Total of ACo's non-foreign losses in bundle' are those losses that meet the condition contained under the first bullet point. Again, both losses meet the condition.

Substituting the relevant amounts into the above formula and assuming that HCo chooses to use 100% of HCo's modified market value, the amount added to ACo's modified market value is:

$$\$1{,}000 \quad \text{x} \quad 100\% \quad \text{x} \quad \frac{\$1{,}100}{\$1{,}100} = \$1{,}000$$

[1] Section 707-350 of the *Income Tax (Transitional Provisions) Act 1997* provides a concession for the utilisation of certain losses that were originally made by a company for an income year ending on or before 21 September 1999 and transferred to the head company because the continuity of ownership and control tests were satisfied.

Adding to ACo's modified market value an amount of BCo's modified market value

Although BCo's modified market value is nil, certain conditions in section 707-327 must be met for HCo to be able to notionally transfer the loss from BCo's bundle into ACo's bundle. One of these conditions requires that the available fraction for the bundle of losses transferred from ACo has to be worked out under section 707-325 on the basis that an amount of BCo's modified market value is added to ACo's modified market value. The condition will be satisfied even where the amount donated is nil, provided that all the conditions relating to the donation of value are met – in other words, the donation has to be effective.

The relevant conditions, as set out in subsections 707-325(1) and (2) are:

- The bundle of losses transferred from ACo must contain either a tax loss or a net capital loss and the utilisation of the loss is not affected by section 707-350.
- BCo, assuming it had made the loss, could have transferred it to the head company (HCo) under Subdivision 707-A.
- ACo could have transferred the loss to BCo under Subdivision 170-A or 170-B for an income year consisting of the trial year.

All of these conditions are met, which means BCo is able to effectively donate a nil amount of its modified market value for the purposes of working out the available fraction for the bundle of losses transferred from ACo.

Available fraction for bundle of losses transferred from ACo

After taking into account donations of modified market value from HCo and BCo, the bundle of losses transferred from ACo has an available fraction of:

$$\frac{0 + 1{,}000 + 0}{1{,}000} = 1.000$$

Treating the loss transferred from BCo as being included in the bundle of losses transferred from ACo

For HCo to notionally transfer the loss from BCo's bundle into ACo's bundle, certain conditions in section 707-327 must be met:

- An amount of modified market value from BCo is added to the modified market value of ACo. (As discussed above, the amount can be nil.)
- The loss is either a net capital loss or a tax loss and the utilisation of the loss is not affected by section 707-350.
- The loss is transferred under Subdivision 707-A from BCo to HCo at the time when the consolidated group comes into existence.

- If BCo is a real loss-maker under a separate application of section 707-325, the loss must not be a loss that provides the basis for working out the available fraction under that application.[2]
- ACo and any of ACo's other value donors, assuming that they had made the loss, could have transferred the loss to HCo under Subdivision 707-A.
- BCo could have transferred the loss to ACo, and to any of ACo's other value donors, under Subdivision 170-A or 170-B for an income year consisting of the trial year.

All of the above conditions are met in respect of the 2002 tax loss of $1,000 transferred from BCo. The last two conditions are met in relation to both ACo and ACo's other value donor (HCo).

Therefore, the 2002 tax loss of $1,000 will be utilised on the basis of it being included in the bundle of losses transferred from ACo. As stated above, the bundle has an available fraction of 1.000.

References

Income Tax Assessment Act 1997 Subdivisions 170-A, 170-B, 707-A; as amended by *New Business Tax System (Consolidation) Act (No. 1) 2002* (No. 68 of 2002), Schedule 1

Income Tax (Transitional Provisions) Act 1997, Subdivision 707-C, sections 707-325, 707-327, 707-328, 707-350; as amended by *New Business Tax System (Consolidation) Act (No. 1) 2002* (No. 68 of 2002), Schedule 2

Explanatory Memorandum to the New Business Tax System (Consolidation) Bill (No. 1) 2002, Chapter 9

[2] In other words, the loss is not covered by paragraphs 707-325(1)(d) and (e) and subsection 707-325(2) in that application of section 707-325.