Worked example

All assets in head company's loss denial pool become assets of leaving entity

Description

This example examines the situation when an entity leaves a consolidated group taking with it all the assets in a particular loss denial pool (LDP) of the head company. The example is based on the following assumptions:

- one or more loss denial pools of the head company were created at formation
- the head company has not had a Subdivision 165-CC changeover time (under the *Income Tax Assessment Act 1997* (ITAA 1997)) during consolidation, and
- neither the head company nor the leaving entity has a changeover time when the entity leaves the group.

The head company (HC) chooses that a loss denial pool of the leaving entity is created with a loss denial balance (LDB) equal to HC's loss denial balance.

The example illustrates the depletion of the leaving entity's loss denial pool and loss denial balance after it leaves the consolidated group.

→ 'Effect of Subdivision 165-CC where an entity leaves a consolidated group', C2-6-120

Commentary

When a consolidated group forms, it may be necessary to create one or more loss denial pools of the head company. If the head company has not had a changeover time during consolidation, there may still be assets in a loss denial pool that a leaving company or trust may take with it when it leaves the consolidated group (provided there is no changeover time at the leaving time). In these circumstances, the head company must choose between three options for dealing with those assets (→ section 715-120, ITAA 1997):

- reduce adjustable values of all such assets to nil
- apply the loss denial balance to reduce the adjustable values of those assets that are loss assets, or
- create a loss denial pool in the leaving entity.

The third choice can only be made when every asset that was in a particular LDP of the HC just before leaving time leaves with the leaving entity. HC has 6 months to make its choice and a further month, after the choice is made, to notify the leaving entity in writing that a LDP has been created in the leaving entity at leaving time. HC must specify the loss denial balance at that time. The Commissioner has the power to extend the period in which the choice can be made and notice given.

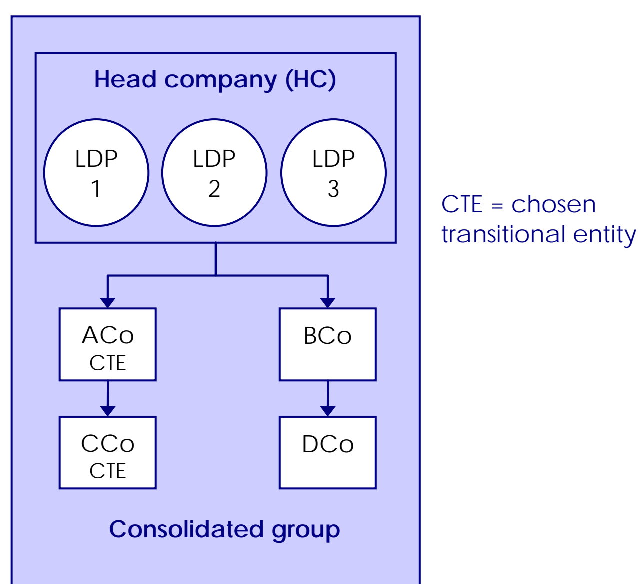
The LDP of the leaving entity consists of all the leaving assets. Its loss denial balance is equal to that of the head company. The LDP of the head company ceases to exist when the LDP of the leaving entity is created.

Example

Facts

A consolidated group is formed on 1 July 2002 with a head company, HC, and subsidiaries, ACo, BCo, CCo and DCo. ACo and CCo are chosen transitional entities → 'Pre-formation changeover times – application of Subdivision 165-CC at formation (transitional period)', C2-6-520. Formation was not a changeover time for the head company and, at that time, HC, ACo and CCo had '165-CC tagged assets' and residual unrealised net losses from changeover times before consolidation. ACo also had a '170-D deferred loss' related to its changeover time. At formation, the three companies– HC, ACo and CCo – failed the same business test and three separate loss denial pools of the head company were created.

Figure 1: Consolidated group at formation



LDP 2 of the head company at formation consists of assets W, X, Y and Z and a 170-D deferred loss. Its loss denial balance is $5,000.

On 30 March 2003, DCo leaves the consolidated group and takes all the assets remaining in LDP 2. DCo does not have a changeover time when it leaves and HC chooses that a LDP of DCo be created.

Calculation

The following explains the creation of the LDP of leaving entity DCo and the impact of various realised losses on the LDP after the entity leaves the consolidated group. Table 1 summarises the effects on the LDP created in DCo at leaving time.

1 December 2002 – asset W realised at a gain of $2,000 during consolidation

During consolidation, asset W is realised and a capital gain of $2,000 is made. Asset W leaves the head company's LDP but, as a gain is realised, the loss denial balance remains unchanged at $5,000.

30 March 2003 – DCo leaves the consolidated group

DCo leaves the consolidated group, taking with it all remaining assets in LDP 2 of the head company. Just before the leaving time, assets X, Y and Z and a 170-D deferred loss remain in HC's LDP2 and the loss denial balance is $5,000.

Treatment of 170-D deferred loss in a LDP at leaving time

Like other losses, 170-D deferred losses (including those in LDPs) cannot leave a consolidated group with a leaving entity. They remain with the head company.

LDP created in leaving entity DCo at leaving time (section 715-135)

All the assets that were in HC's LDP 2 just before the leaving time leave with DCo. The assets leave HC's LDP when they become assets of the leaving entity. HC chooses the third of the available options and creates a LDP in the leaving entity, DCo. The assets and loss denial balance ($5,000) of the new LDP are the same as those of the head company's LDP 2 (see table 1). When the LDP is created in DCo, the head company's LDP 2 ceases to exist.

HC has 6 months after leaving time to make the choice to create the LDP in the leaving entity, and a further month after the choice is made to notify DCo that a LDP has been created at leaving time and to advise DCo of the loss denial balance at that time.

29 October 2003 – asset X realised at a loss

Asset X realises a $2,000 capital loss that is denied → section 715-160. Asset X leaves DCo's LDP and the loss denial balance is reduced by $2,000 to $3,000.

Note that a same business test is not required for realised losses on assets in a loss denial pool as the test has already been failed.

15 February 2004 – asset Y realised at a loss

Asset Y realises a capital loss of $3,000 that is not allowed. Asset Y leaves DCo's LDP and the loss denial balance is reduced by $3,000 to nil.

Loss denial balance becomes nil

When the loss denial balance becomes nil, the LDP ceases to exist. Asset Z, the remaining asset, is no longer attached to a LDP and any loss, deduction or gain, when it is realised will be subject to normal rules.

DCo may choose to cancel the LDP

Within 6 months, or a further period allowed by the Commissioner, of the LDP being created in the leaving entity (DCo), DCo may choose to cancel the LDP created by HC. Either of the other two choices are available to it – the first under section 715-125, or the second under section 715-130. Both of these options will result in the adjustable values of leaving assets being

reduced. DCo's LDP will cease to exist just after the leaving time. HC's LDP still ceases to exist at the leaving time (as it did under the third choice).

Table 1: LDP created in DCo at leaving time – reduction

Events affecting LDP assets	Loss denial balance
	$5,000
X – $2,000 loss realised 29.10.03 – asset leaves LDP	$3,000
Y – $3,000 loss realised 15.2.04 – asset leaves LDP	$0
Z – remaining asset	
Loss denial pool ceases to exist	**$0**

References

Income Tax Assessment Act 1997, Subdivisions 165-CC and 170-D

Income Tax Assessment Act 1997, Division 715; as amended by *New Business Tax System (Consolidated and Other Measures) Act 2003* (No. 16 of 2003), Schedule 7

Explanatory Memorandum to the New Business Tax System (Consolidation and Other Measures) Bill (No. 2) 2002, Chapter 11