Worked example

Transfer and utilisation of a tax loss with a foreign loss component where the loss maker joins part-way through the head company's income year

Description

This example shows the application of the transfer rules under Subdivision 707-A of the *Income Tax Assessment Act 1997* (ITAA 1997) and the deduction limit under section 770-30 of the *Income Tax (Transitional Provisions) Act 1997* (IT(TP)A) where a subsidiary member with a convertible foreign loss joins part-way through the head company's income year.

Note

For more information on:

- transferring losses to a consolidated group see → 'Treatment of losses', C3-1; 'Consolidation loss provisions', C3-2-110 (high-level worked example); and worked examples C3-3-105 to C3-3-270.
- the application of the available fraction method in determining the limits for utilisation of transferred losses where there is a foreign loss component of a tax loss see → 'Amount of transferred losses that can be utilised – foreign loss component of a tax loss', C3-4-560.

Commentary

Subdivision 707-A of the ITAA 1997 sets out the rules governing the transfer of unutilised losses from a joining entity to a head company. As per paragraph 707-115(1)(a), the Subdivision only applies in respect of a 'sort of loss'. As a convertible foreign loss is treated as a tax loss, this requirement is satisfied.

In addition, paragraph 707-115(1)(b) of the ITAA 1997 requires that the 'sort of loss' must be made by the joining entity in an income year ending before the joining time. Specifically section 707-120 of the ITAA 1997 requires a loss to be tested as if the joining entity was in a position to utilise the loss itself in the context of the trial year and had sufficient income or gains to do so. To the extent that the loss could be so utilised, it is transferred as at the joining time.

As section 770-1 of the IT(TP)A treats the convertible foreign loss of an earlier income year as a tax loss only for the purposes of the commencement year and later income years, a modification is made so that the joining entity is not prevented from satisfying the requirement where the joining time is in the commencement year. This modification, in section 770-90 of the IT(TP)A, ensures that section 770-1 operates in relation to the trial year in such circumstances.[1]

[1] Note that the deduction limit imposed on the foreign loss component of a tax loss does not prevent the whole of the tax loss (or the undeducted amount) from being transferred from a joining entity to a head company – section 770-85 of the IT(TP)A.

When a tax loss having a foreign loss component is transferred to the head company of a consolidated group, the head company inherits the following history:

- the foreign loss component of the tax loss, and
- the starting total (ie, the sum of all convertible foreign losses for which an entity is taken to have a tax loss → section 770-20, IT(TP)A) for the loss parcel to which the tax loss belongs.

→ section 770-95, IT(TP)A

Where a subsidiary member has a non-membership period, it will deduct the foreign loss component of the tax loss up to the deduction limit in section 770-30 of the IT(TP)A (subject to the usual loss recoupment tests) in that non-membership period. This is because a non-membership period is treated as an income year under subsection 701-30(3) of the ITAA 1997.

If the non-membership period ends before the end of the head company's income year mentioned in an item in the table in subsection 770-30(1) of the IT(TP)A, the head company must reduce its deduction limit by the amount utilised by the joining entity in that non-membership period.

→ section 770-100, IT(TP)A

Example

Facts

SubCo joins a consolidated group part-way through the head company's income year on 1 January 2009. SubCo has a tax loss with a 100% foreign loss component in a loss parcel with a starting total of $500,000. SubCo has a deduction limit of 1/5 of the starting total ($500,000 x 1/5 = $100,000 → subsection 770-30(1)) in its commencement year, 1 July 2008 to 31 December 2008 (the non-membership period). Due to insufficient income, SubCo could only deduct $50,000 of the loss in the non-membership period.

It is necessary to determine the extent to which this tax loss with the foreign loss component can be transferred from SubCo to HCo, the head company, under Subdivision 707-A of the ITAA 1997 and how much of the tax loss can be utilised by HCo in the 2009 income year. (As the first income year starting on or after 1 July 2008, this is also the commencement year.)

Calculation

1. Determine the unutilised amount of the foreign loss component at the joining time

$500,000 – $50,000* = $450,000

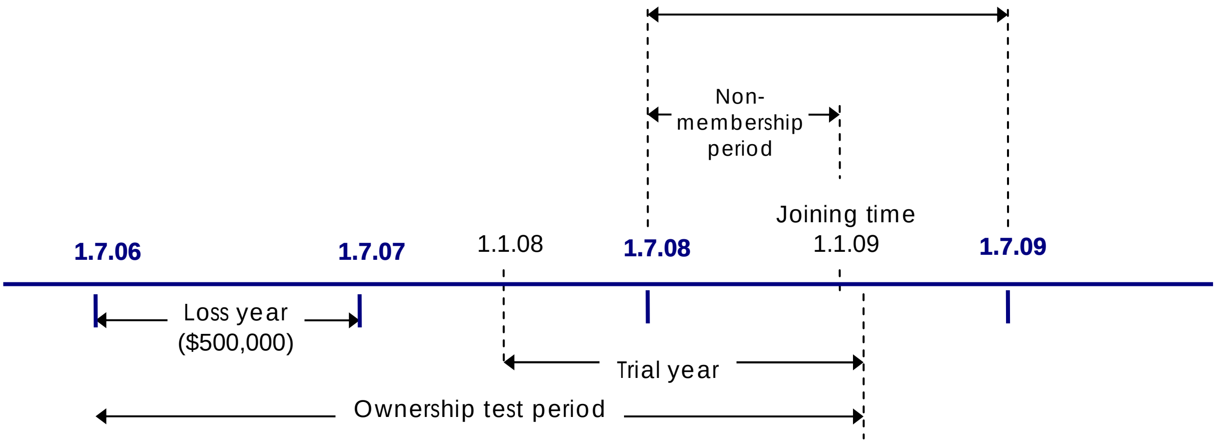
(*SubCo could only deduct $50,000 in the non-membership period due to insufficient income.)

2. Transferring the tax loss to HCo at the joining time

Sections 165-12 and 165-15 of the ITAA 1997 require the company to test for same owners and same control throughout the ownership test period – from the start of the loss year to the end of the income year. In this case, assume:

- the loss year is 1 July 2006 to 30 June 2007, and
- the income year is represented by the trial year 1 January 2008 to just after 1 January 2009.

Figure 1: Ownership test period



As part of the trial year occurs before the start of the commencement year, section 770-90 of the IT(TP)A applies to ensure that the conversion of the foreign loss to a tax loss under section 770-1 of the IT(TP)A is possible in relation to the trial year. The convertible foreign loss is therefore treated as a tax loss for an income year beginning before the commencement year.

If the testing process concludes that there is no ownership or control failure over the relevant test period, the $450,000 tax loss is transferred to the head company.

3. Utilising the transferred tax loss

If the $450,000 tax loss is transferred to HCo on SubCo joining the consolidated group, HCo is treated as having made the loss in the 2009 income year.

Section 770-95 ensures the following pre-transfer characteristics of the tax loss are retained:

- the foreign loss component of the tax loss is $450,000
- the starting total is $500,000.

As the 2009 income year is the commencement year, HCo's deduction limit in respect of the transferred tax loss is calculated in accordance with item 1 of the table in subsection 770-30(1) of the IT(TP)A, as follows:

($500,000 x 1/5) = $100,000

Subsection 770-100(2) of the IT(TP)A then reduces this limit by the amount worked out under subsection 770-100(3). In effect, this limit is reduced by the amount utilised by SubCo in respect of its non-membership period as follows:

$100,000 – $50,000 = $50,000

References

Income Tax Assessment Act 1997, Subdivision 707-A

Income Tax (Transitional Provisions) Act 1997, Subdivisions 770-A and 770-B

Explanatory Memorandum to the New Business Tax System (Consolidation) Bill (No. 1) 2002, Chapter 6

Explanatory Memorandum to the Tax Laws Amendment (2007 Measures No.4) Bill 2007, Chapter 1

Revision history

Section C3-4-570 first published 15 April 2010.

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).