*Worked example*

# Subdivision 165-CD widely held company concession for an eligible tier-1 company that is head company of a consolidated or MEC group

## Description

This example outlines the modifications to the inter-entity loss multiplication rules in Subdivision 165-CD of the *Income Tax Assessment Act 1997* (ITAA 1997) for:

- the head company of a consolidated group that is itself an eligible tier-1 company (a foreign-owned consolidated group), and
- the head company of a multiple entry consolidated (MEC) group.

Under the modifications to Subdivision 165-CD, the head company of a MEC group or foreign-owned consolidated group can be treated as not having a relevant equity interest or relevant debt interest in a loss company, if the top company is widely held and does not have such an interest in the loss company.

Where the head company does not have a relevant equity interest or relevant debt interest in a loss company at a particular time, Subdivision 165-CD does not apply. For example, the adjustments set out in sections 715-255 and 715-270 of the ITAA 1997 do not need to be made to the tax cost setting amount of membership interests of the leaving entity just before the leaving time if the leaving entity is a loss company at the leaving time. The head company is not prevented from realising the loss on the membership interests.

Amendments to Subdivision 165-CD and Part 3-90 of the ITAA 1997 reduce compliance costs and make it easier for widely held companies to claim capital losses or deductions on the disposal of direct or indirect interests in loss companies. The amendments apply from 1 July 2002.

→ 'Effect of Subdivision 165-CD for MEC groups', C2-6-150; 'Effect of Subdivision 165-CD for consolidated groups', C2-6-130

## Commentary

If one or more entities are interposed between individual shareholders and a company with realised or unrealised losses (a loss company), the company's losses could be reflected in the value of shares and loans held between such entities (inter-entity interests). The inter-entity loss multiplication rules ensure that the economic losses of companies do not get inappropriate multiple tax recognition when inter-entity interests are sold or otherwise realised.

The inter-entity loss multiplication rules do not apply to a company if it satisfies the exceptions in subsections 165-115X(3) or 165-115Y(4) of the ITAA 1997. However, widely held companies have difficulty in satisfying these exceptions, and as a result the losses of a loss company receive no tax recognition at all in some circumstances.

The modifications make it easier for a widely held company to recognise a capital loss or deduction on the disposal of a direct or indirect interest in a loss company by treating the company as not having a relevant equity interest or a relevant debt interest in the loss company in most cases.

A 'widely held company' is defined in subsection 995-1(1) of the ITAA 1997 to mean broadly:

- a company whose shares are listed for quotation in the official list of an approved stock exchange, or
- a company that has more than 50 members, but not if 20 or fewer persons have rights to at least 75 per cent of the value of the shares in the company or at least 75 per cent of the voting power or dividend rights of the company.

The three conditions that must be satisfied in order for the loss multiplication rules in Subdivision 165-CD of the ITAA 1997 to apply (→ subsection 165-115K(1), ITAA 1997) are:

- an alteration time happens in respect of a company (→ sections 165-115L, 165-115M, 165-115N, 165-115P and 165-115Q), and
- the company is a loss company at the alteration time, and
- an entity has a relevant equity interest (→ section 165-115X) or relevant debt interest (→ section 165-115Y) in the loss company immediately before the alteration time.

Where a widely held company does not have a relevant equity interest or relevant debt interest in a loss company, one of the three conditions will not be satisfied and Subdivision 165-CD will not have effect.

A widely held company will not have a relevant equity interest or relevant debt interest in a loss company at a particular time except in two circumstances.

The first is where an entity has a controlling stake in the loss company (→ section 165-115Z, ITAA 1997), and that entity also has a direct or indirect interest in, or is owed a debt by, the widely held company in respect of which:

- the entity could, if a CGT event happened in respect of the interest or debt make a capital loss (other than one that would be disregarded) that reflects any part of the loss company's overall loss, or
- the entity has deducted or can deduct, or could deduct at a later time, an amount in respect of the cost of the acquisition, or a net loss on the disposal, of the interest or debt, where the deduction reflected or would have reflected, or would reflect, any part of the loss company's overall loss.

The second is where an entity that had a direct or indirect interest in, or was owed a debt by, the widely held company at an earlier time, and had a controlling stake in the loss company at the earlier time:

- made a capital loss (other than a capital loss that was disregarded) because a CGT event happened in respect of the interest or debt where the capital loss reflected any part of the loss company's overall loss, or
- has deducted or could have deducted at an earlier time, or could deduct at a later time, an amount in respect of the cost of the acquisition, or net loss on the disposal, of the interest or debt, where the deduction reflected or would have reflected, or would reflect, any part of the company's overall loss.

→ Explanatory Memorandum to the Tax Laws Amendment (2010 Measures No. 1) Bill 2010, paragraphs 5.334 – 5.339

## Consolidated group

Subdivision 715-B of the ITAA 1997 modifies how the inter-entity loss multiplication rules apply to the head company of a consolidated group.

Amendments to Subdivision 715-B of the ITAA 1997 apply where:

- the head company of a consolidated group is an eligible tier-1 company (→ section 719-15, ITAA 1997) of a top company (→ section 719-20, ITAA 1997), and
- the top company is a widely held company.

In these circumstances, the head company of the consolidated group does not have a relevant equity interest or relevant debt interest in a loss company at a particular time if the widely held top company does not have such an interest in the loss company at that time.

→ section 715-265, ITAA 1997

To ensure that any loss allowed to the head company of the consolidated group is not also recognised by other entities holding certain interests in the head company, the loss reduction method (LRM) applies in relation to:

- direct or indirect equity or loan interests in the head company, and
- external indirect equity or loan interests in the head company.

Generally, where the LRM applies, the loss realised for income tax purposes is reduced to nil, with the effect that the loss is cancelled.

→ 'Application of the loss reduction method to consolidated and MEC groups', C2-6-160; section 715-610, ITAA 1997

## Example 1

### Facts

TCo is a foreign-resident company that satisfies the requirements to be a top company.

TCo is a widely held company and none of the entities that hold interests in, or are owed a debt by, TCo have a controlling stake in LossCo.

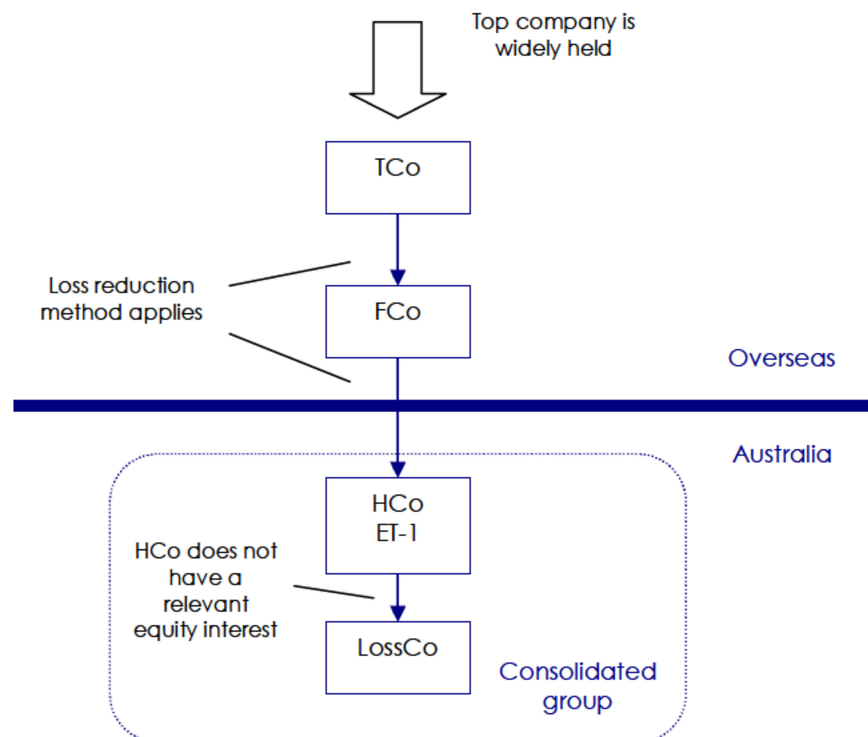
FCo is a foreign-resident company wholly owned by TCo.

HCo is head company of the consolidated group and it is wholly owned by FCo.

LossCo is a subsidiary member of the consolidated group and is a loss company for the purposes of Subdivision 165-CD.

HCo disposes of its shares in LossCo to an entity outside the consolidated group.

**Figure 1: Consolidated group example**




### Application

TCo is a widely held company, and none of the entities that hold direct or indirect interests in, or are owed a debt by, TCo have a controlling stake in LossCo. Therefore, TCo does not have a relevant equity interest in LossCo at the time HCo disposes of the membership interests in LossCo to a company that is not a member of the consolidated group.

As widely held TCo does not have a relevant equity interest in LossCo, the head company, HCo, does not have a relevant equity interest in LossCo at the time HCo disposes of LossCo to an entity outside the group. Therefore,

adjustments under section 715-255 of the ITAA 1997 do not need to be made to the tax cost setting amount of the membership interests in LossCo just before the leaving time, with the result that the loss is available to the head company HCo.

The loss reduction method in section 715-610 of the ITAA 1997 applies to TCo's interests in FCo and FCo's interests in HCo if the realisation of these interests results in a loss for income tax purposes.

MEC group

Subdivision 719-T of the ITAA 1997 clarifies how the inter-entity loss multiplication rules in Subdivision 165-CD apply to MEC groups.

The head company of a MEC group is ultimately wholly owned by a top company and therefore it cannot meet the definition of a widely held company. However, section 719-740 of the ITAA 1997 modifies the operation of the inter-entity loss multiplication rules where the top company of a MEC group is a widely held company. In these circumstances, the head company of the MEC group does not have a relevant equity interest or relevant debt interest in a loss company at a particular time if the widely held top company does not have such an interest in the loss company at that time.

## Example 2

### Facts

TCo is a foreign-resident company and is the top company of a MEC group.

TCo is a widely held company, and none of the entities that hold interests in, or are owed a debt by, TCo have a controlling stake in LossCo.

FCo is a foreign resident company wholly owned by TCo.

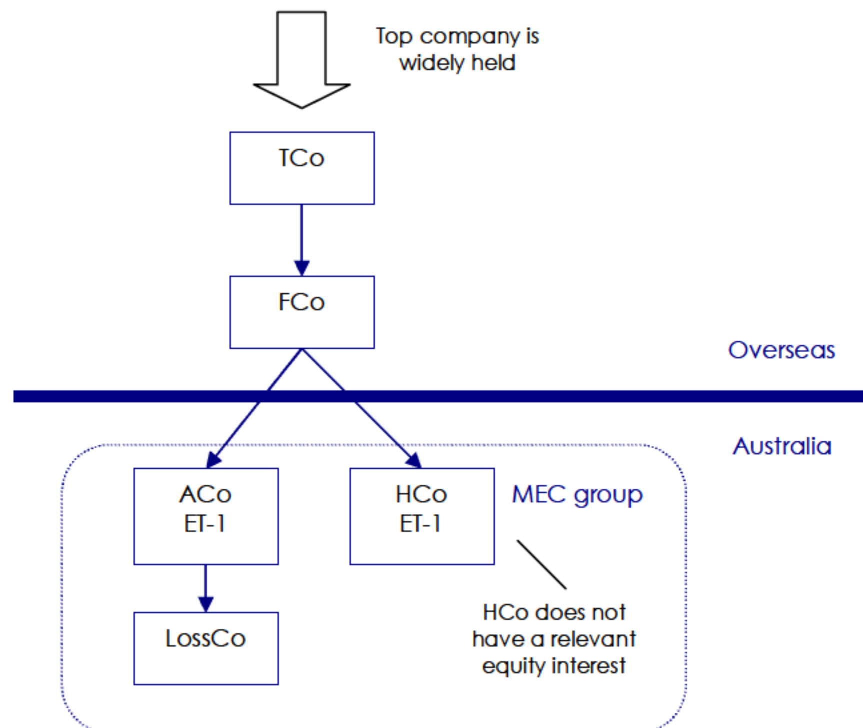
HCo is the head company of a MEC group.

ACo is an eligible tier-1 company and a subsidiary member of the MEC group.

LossCo is a subsidiary member of a MEC group and is a loss company for the purposes of subdivision 165-CD.

HCo disposes of its shares in LossCo to an entity outside the MEC group.

**Figure 2: MEC group example**




### Application

TCo is a widely held top company of a MEC group, and none of the entities that hold direct or indirect interests in, or are owed a debt by, TCo have a controlling stake in LossCo. Therefore, TCo does not have a relevant equity interest in LossCo at the time the membership interests in LossCo are disposed of to a company that is not a member of the MEC group.

As widely held TCo does not have a relevant equity interest in LossCo, the head company, HCo, does not have a relevant equity interest in LossCo at the time LossCo leaves the MEC group. Therefore, adjustments under section

715-255 of the ITAA 1997 do not need to be made to the tax cost setting amount of the membership interests in LossCo just before the leaving time, with the result that any loss is available to the head company.

## References

*Income Tax Assessment Act 1997,* Sections 719-740 and 715-265; as inserted by *Tax Laws Amendment (2010 Measures No. 1) Act 2010* (No. 56 of 2010) Schedule 5, Part 16

*Income Tax Assessment Act 1997,* Sections 165-115X, 165-115Y, 715-230 (note 1), 715-255, 715-270, 715-450 (note) and 715-610; as amended by *Tax Laws Amendment (2010 Measures No. 1) Act 2010* (No. 56 of 2010) Schedule 5, Part 16

Explanatory Memorandum to Tax Laws Amendment (2010 Measures No. 1) Bill 2010, Chapter 5, paragraphs 5.325 – 5.348

Supplementary Explanatory Memorandum to Tax Laws Amendment (2010 Measures No. 1) Bill 2010, Chapter 2, paragraphs 2.26 – 2.32

### Revision history

Section C2-6-155 first published 6 May 2011.