Worked example

Establishing unutilised loss at transfer time – multiple joining times and prior year and current year loss case

Description

An entity may join a consolidated group more than once in an income year. The entity that joins a consolidated group transfers any unutilised losses on hand at each of the respective joining times to the head company of the group joined at that time. As shown in this example, the entity must establish what losses are unutilised at each of these points in time in the joining year.

Commentary

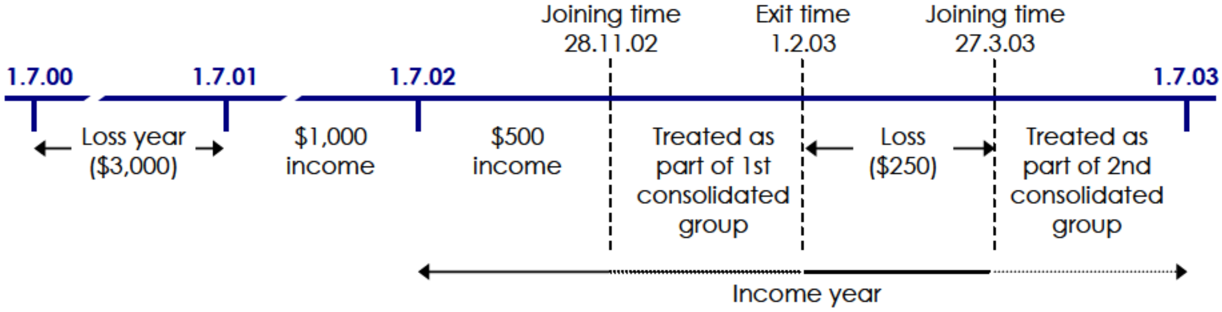
Section 707-115 states that when an entity joins a consolidated group, only a loss made by the entity for an income year ending before the joining time is subject to the transfer provisions (of Subdivision 707-A). Subsection 707-115(2) requires that only the unutilised amount of a loss is subject to the subdivision.

Example

Facts

An entity joins a consolidated group on 28 November 2002, exits from this group on 1 February 2003 and subsequently joins another consolidated group on 27 March 2003. It has a tax loss on hand from the 2001 income year. The loss in the 2001 income (loss) year is $3,000 and the entity utilised $1,000 of this to calculate a nil taxable income for the 2002 income year. The entity's assessable income for the joining year, calculated for the first period of the joining year (1 July 2002 to 27 November 2002), is $500 before the deduction for prior year losses. For the second period in the joining year for which it has entity responsibility, it calculates a tax loss amount of $250.

Figure 1: Joining entity timeline



The income year of the joining entity is 1 July 2002 to 30 June 2003. Its core purposes are calculated in respect of the non-membership periods in the income year (that is, 1 July 2002 to 27 November 2002 and 1 February 2003 to 26 March 2003).

To establish the amount of the loss on hand at the first joining time (28 November 2002), the entity needs to bring to account its loss for the 2001 income year. As the loss is greater than the income in that period 1 July 2002 to 27 November 2002 in the joining year, the unutilised amount of the 2001 loss is subject to the transfer testing process.

In respect of the second joining time, the joining entity needs to establish that the $250 loss for its second non-membership period in the year is an unutilised loss for an income year that ends before the joining time.

Calculation

As there are two loss amounts to consider, each is looked at in order of the respective joining times of the joining entity within the joining year. Note that Division 701 applies to determine how the entity's core purposes are to be met. Each non-membership period identified in the income year is considered as though it were the only period, and as though it was the income year.

In respect of the first joining time:

Step 1: Identify the loss

A tax loss of $3,000 is identified at the first joining time. Subsection 701-1(4) lists the sorts of losses that are subjected to Subdivision 707-A. Paragraph 707-110(2)(a) states how a tax loss is 'utilised'.

Step 2: Income year

In respect of the $3,000 tax loss, the loss was made in the 2001 income year. As 30 June 2001 (the end of the income year) pre-dates the first joining time of 28 November 2002, the loss is for an income year ending before the joining time.

Thus, a loss of $3,000 of the joining entity satisfies the criteria for application of the loss transfer subdivision.

Step 3: Does a modified rule apply?

Not necessary as both steps 1 and 2 satisfied.

Step 4: Establish the unutilised amount of the loss at the joining time

The joining entity has already utilised $1,000 of the 2001 year loss in working out its taxable income for the 2002 income year.

Thus, it has $2,000 unutilised (that is, $3,000 – $1,000) at the beginning of the 2003 income year. In calculating its taxable income for the 2003 income year, the joining entity is able to utilise $500 of the loss (assuming the recoupment tests are satisfied). The joining entity is required, in this case, to calculate its taxable income with reference to Division 701.

This satisfies the requirement in paragraph 707-115(2)(b) that only the net amount of the loss is subject to the transfer testing process. It was utilised to the extent of $500 ‘in working out the joining entity’s taxable income (if any) for the joining year’ and $1,000 in respect of an ‘earlier income year’.

Outcome

The $1,500 remaining of the joining entity’s 2001 loss is subject to the transfer testing process.

In respect of the second joining time:

Step 1: Identify the loss

At the second joining time, a loss amount of $250 is calculated for the period 1 February 2003 to 26 March 2003.

The entity’s core purposes (working out taxable income, income tax liability, losses – if any) are governed by Division 701. Only a loss that is calculated for a non-membership period that ends at the end of the income year can be considered a loss of a particular sort for the income year[1].

The non-membership period loss as calculated is not – in the absence of a modified rule – considered a loss of a sort to which Subdivision 707-A applies.

Step 2: Income year

As the income year in which the non-membership period loss is made is the joining year, that is, the 2003 income year, it follows that it is made in an income year that ends after the second joining time – that is, 30 June 2003 follows 27 March 2003.

Accordingly, it is not subject to the subdivision unless a modified rule applies.

Step 3: Does a modified rule apply?

As a non-membership period loss has been identified, subsection 701-30(8) treats it as being a loss for an income year for transfer purposes in relation to the second joining time.

The loss of $250 is now a tax loss (thus satisfying step 1); and it is for an income year that ends before the second joining time (thus satisfying step 2).

Step 4: Establish the unutilised amount of the loss as at the joining time

With respect to subsection 707-115(2), the 2003 loss has not been utilised ‘in working out the joining entity’s taxable income (if any) for the joining year’ to any extent. Thus the full $250 remains unutilised as at the second joining time.

[1] Subsection 701-30(7).

Outcome

The full $250 of the joining entity's 2003 loss is subject to the transfer testing process in section 707-120.

References

Income Tax Assessment Act 1997 – as amended by *New Business Tax System (Consolidation) Act (No. 1) 2002* (No. 68 of 2002), Schedule 1:

- subsection 701-1(4)
- subsection 701-30(7)
- Subdivision 707-A
- paragraph 707-110(2)(a)
- section 707-115
- paragraph 707-115(1)(b),
- subsection 707-115(2)
- section 707-120

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

Income Tax Assessment Act 1997, subsection 701-30(8); as amended by *New Business Tax System (Consolidation and Other Measures) Act 2003* (No. 16 of 2003), Schedule 19

Explanatory Memorandum to the New Business Tax System (Consolidation and Other Measures) Bill (No. 2) 2002, Chapter 6