

## Worked example

## Transfer testing with modified same business test – where head company transfers losses to itself

**Description** This example shows how the modified same business test applies where the head company transfers losses to itself.

**Commentary** On formation of a consolidated group, losses made in prior income years by the head company in its capacity as a single entity are transferred to itself in its capacity as the head company of the group.<sup>1</sup>

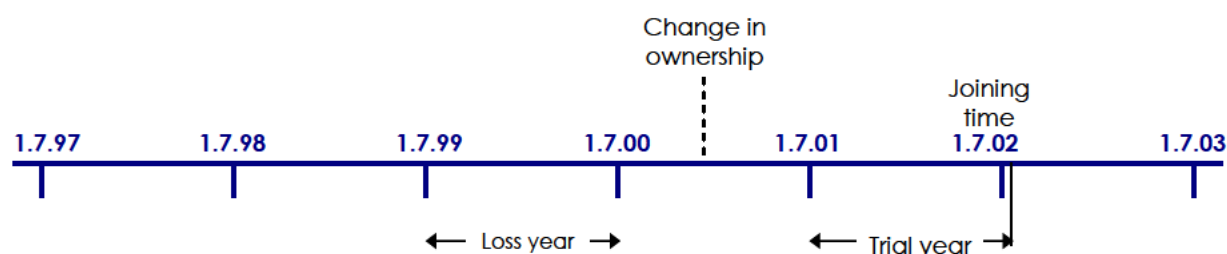
If a joining entity makes a loss for an income year starting after 30 June 1999 and subsection 165-13 or 166-5(4) or (5) of the *Income Tax Assessment Act 1997* is relevant to working out (under subsection 707-120(1)) whether the loss is transferred from the joining entity to the head company (even if they are the same entity), the modified same business test must be considered. The modified same business test for losses is stricter than the normal same business test.

Section 707-125 introduces an additional test point just before the end of the income year in which the loss is made, and tests all of the income year in which the ownership or control tests are failed.

### Example

**Facts** A head company (HC) forms a consolidated group on 1 July 2002. At the joining time HC has an unutilised tax loss of \$1,500 from the 2000 income year. It had experienced a 90% change in ownership before the trial year but after the loss year. HC also incurs a tax loss in the year of transfer (the 2003 income year), and is required to transfer the tax loss to itself at the joining time.

Figure 1: Joining entity timeline



<sup>1</sup> Subsection 707-120(1).

## Calculation Step 1: Apply the continuity of ownership or control test

In this case an ownership failure is identified within the ownership test period 1 July 1999 to just after 1 July 2002. Accordingly, HC would be unable to claim a deduction for the loss under this test in respect of the trial year. Section 165-10 provides an alternative qualifying test that requires HC to meet the conditions about carrying on the same business.

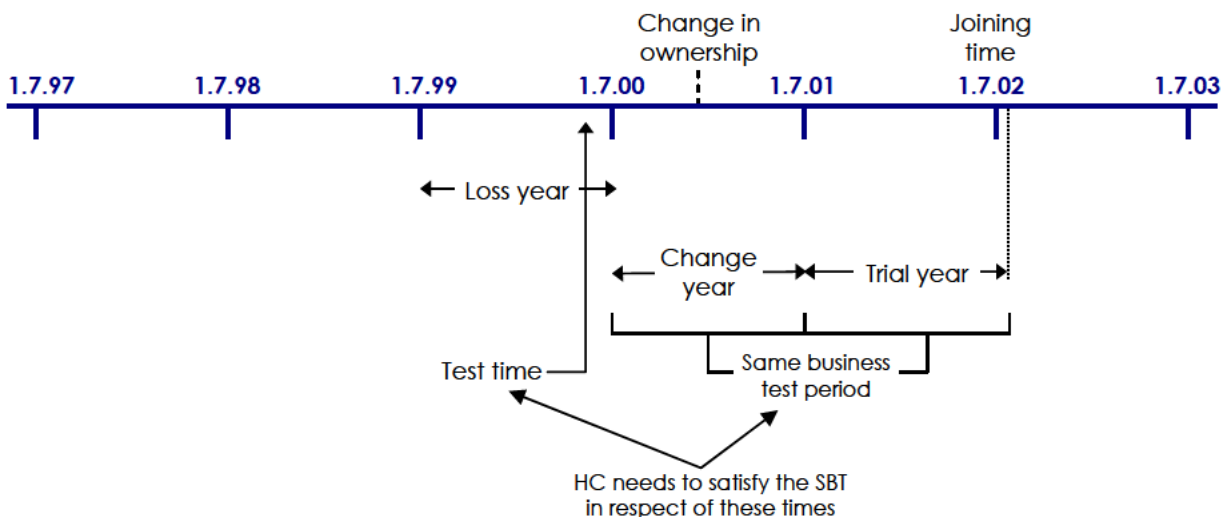
## Step 2: Apply the modified same business test

As section 165-13 is relevant to working out the transfer of the loss to HC, HC is required to apply the modified same business test as stipulated in section 707-125. The modified same business test requires HC to satisfy the same business test for:

- the same business test period, consisting of:
  - the trial year, and
  - the income year in which the continuity period ended (the change year), if that income year started before the trial year, and
- the test time, being the time just before the end of the income year for which the loss was made by HC.

As shown in figure 2, the change year in which the continuity period ends starts before the start of the trial year. As such, the same business test period consists of a continuous period – 1 July 2000 to just after 1 July 2002.<sup>2</sup>

Figure 2: Modified same business test points



<sup>2</sup> Note that in accordance with subsection 707-120(3) the same business test period effectively ends immediately before the joining time (1 July 2002). This is achieved by assuming that the business carried on by the joining entity at and just after the joining time is the same as the business it carried on immediately before the joining time.

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#### **Step 4: Apply the same business test**

The joining entity now applies the section 165-210 same business test in respect of the identified test times to work out whether the loss is transferred.

**Outcome** If the testing process concludes that the same business test is met at the relevant test times, the loss is transferred to the head company (from itself in this instance).

If the test is not met, the loss is not transferred to the head company and its utilisation is restricted in accordance with section 707-150 – that is, it cannot be used by any entity for the 2003 and later income years.

The loss made by the head company for the 2003 income year does not need to be transfer tested at the joining time as it is not a loss in respect of an income year that ends before the joining time. This loss is treated as a ‘group’ loss of the head company.

**References** *Income Tax Assessment Act 1997:*

- section 165-10
- section 165-12
- section 165-13 (as amended by Taxation Laws Amendment Bill (No. 5) 2003)
- subsections 166-5(4), 166-5(5)
- section 165-210

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

- subsections 707-120(1), 707-120(3)
- section 707-125 (as amended by Taxation Laws Amendment Bill (No. 5) 2003)
- section 707-150

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