

Worked example

Adding to modified market value to reflect loss transferability – loss made for an income year ending just before the initial transfer time

Description A loss entity (the ‘real loss-maker’), in calculating its available fraction, may add to its modified market value the modified market value of another company (the ‘value donor’). Certain losses from the value donor are also able to be transferred notionally to the real loss-maker’s bundle. This enables those losses to be utilised using the available fraction for the real loss-maker.

This example shows how the value donor concession operates in circumstances where the loss in question is made in an income year ending just before the initial transfer time.

Note

For more information about:

- loss bundles and calculating the available fraction → ‘Treatment of losses’, C3-1; ‘Consolidation loss provisions’, C3-2-110 (high-level worked example)
- working out modified market value → ‘Modified market value of a single joining entity’, C3-4-110 (worked example)

Commentary Subdivision 707-C of the *Income Tax (Transitional Provisions) Act 1997* sets out the operation of the value donor concession. In broad terms:

- For a company to be a value donor, it must be a company to which the real loss-maker could have transferred, under the group loss transfer rules in Division 170 of the *Income Tax Assessment Act 1997*, at least one of the losses in its bundle.
- To be eligible for the concession, both the real loss-maker and the value donor must be companies that join the group when it first consolidates, and the group must consolidate during the transitional period (that is, 1 July 2002 to 30 June 2004).

Division 170 generally applies when a company seeks to transfer a loss in a particular income year (i.e. the deduction year for a tax loss or the application year for a capital loss). In determining whether that condition is met in the value donor context, the deduction or application year is replaced under subsection 707-328 of the *Income Tax (Transitional Provisions) Act 1997* with a period that:

- starts at the later of these times:
 - the start of the trial year → subsection 707-120(2), and
 - the start of the loss year, and
- ends just after the time the company joins the group.

Subsection 707-328(6) states that where the loss is made in the income year ending just before the joining time, it is taken to be made in the notional deduction or application year described above. This ensures that subsections 170-35(2) and 170-140(3) apply correctly. They prohibit the transfer of a loss where the loss year and the deduction or application year are the same if the loss was calculated under:

- the current year loss rules (in sections 165-70 or 165-114), or
- the income injection rules (in sections 175-35 or 175-75).

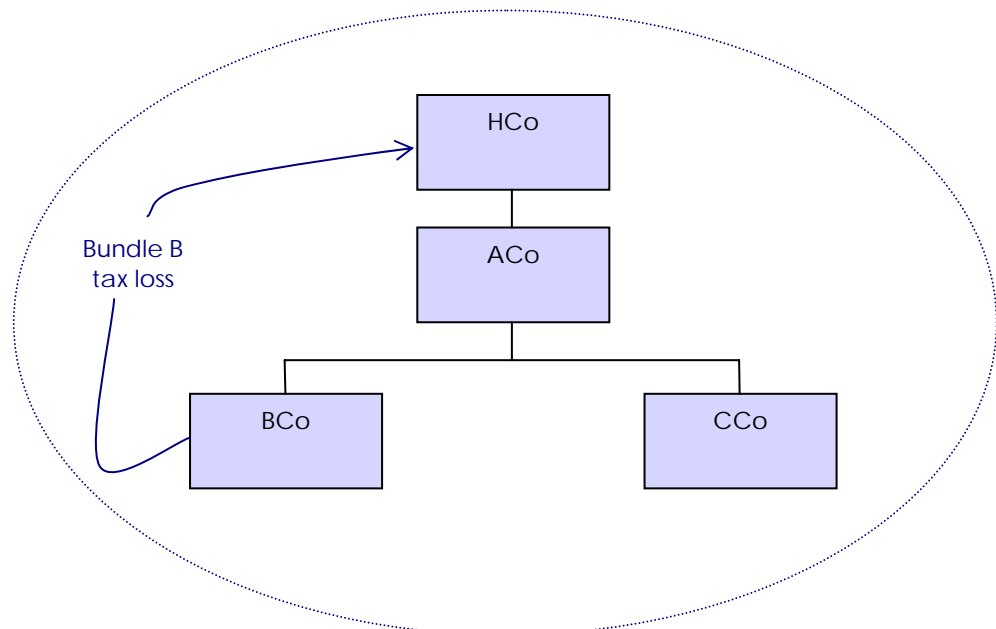
Example

Facts ACo, BCo and CCo have constituted a wholly-owned group for a number of years. HCo acquires 80% of ACo on 30 September 2002 (it previously held 0%). It acquires the remaining 20% on 21 March 2003. The group chooses to consolidate on that date. BCo begins to carry on a different business during the period 1 October 2002 to 20 March 2003. (There have been no changes in the underlying shareholders of HCo during this time.)

BCo's tax loss for the period 1 July 2002 to 20 March 2003, as calculated under section 165-70, is \$1,000. The loss for the period after the change in majority ownership is \$500.

The group seeks to transfer all or part of the tax loss to HCo on consolidation and also to apply the value donor concession.

Figure 1: HCo group



Calculation **Amount of loss (if any) that can be transferred to HCo**

The tax loss of \$1,000 calculated in accordance with section 165-70 cannot be transferred to HCo. BCo would not meet either of the conditions in section 165-10 if its income year consisted of the trial year because it has a change in majority ownership, as well as a change in its business.

However, \$500 of the tax loss incurred after the ownership change can be transferred to HCo because section 165-20 would enable BCo to deduct that amount in an income year consisting of the trial year.¹

Application of value donor concession to loss transferred from BCo

For the value donor concession to apply, BCo must have been capable of transferring the loss to another member of the group under Subdivision 170-A in a notional income year commencing on 1 July 2002 and ending just after 21 March 2003. → subsection 707-328(2)

As the loss is made for an income year ending just before the joining time², subsection 707-328(6) deems the loss to be made for an income year commencing on 1 July 2002 and ending just after 21 March 2003 – in other words, the notional loss year and the notional deduction year are the same. Therefore, for the loss to be transferred the condition in subsection 170-35(2) must be met. Subsection 170-35(2) prohibits the transfer of a loss if it is calculated under the current year loss rules in section 165-70, and the loss year and the deduction year are the same.

As the loss here, part of which is transferred to HCo via section 165-20, would be calculated under the current year loss rules for the notional loss year, the condition in subsection 170-35(2) cannot be met. The loss cannot be transferred to another member of the group. As the loss is the only loss in the bundle transferred from BCo, the value donor concession will not apply here.

References

Income Tax Assessment Act 1997, sections 165-10, 165-20, 165-70

Income Tax Assessment Act 1997, Division 701, Subdivision 707-A; as amended by *New Business Tax System (Consolidation) Act (No. 1) 2002* (No. 68 of 2002), Schedule 1

Income Tax (Transitional Provisions) Act 1997, Subdivision 707-C; as amended by *New Business Tax System (Consolidation) Act (No. 1) 2002* (No. 68 of 2002), Schedule 2

Explanatory Memorandum to the New Business Tax System (Consolidation) Bill (No. 1) 2002, Chapters 2, 6 and 9

¹ Section 165-20 allows the deduction if, assuming that the part of the loss year after the disqualifying ownership change was treated as the whole of the loss year, section 165-10 would not prevent BCo from deducting that part of the loss incurred in that part of the loss year. As there has only been a 20% change in the underlying ownership of BCo since the disqualifying ownership change that took place on 30 September 2002, this condition is satisfied. (It is assumed that the control test in section 165-15 is satisfied.)

² Subsection 701-30(8) deems a loss made for a non-membership period described in section 701-30 to be a loss made for an income year consisting of the non-membership period.

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