Worked example

Adding to modified market value to reflect loss transferability – including foreign losses

Description

As shown in this example, 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, including foreign losses, are also able to be transferred notionally. This enables those losses to be utilised using the available fraction for the real loss-maker.

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).

The head company may also treat one or more of the value donor's losses as if it was included in the real loss-maker's bundle for the purpose of determining the amount of the losses that can be utilised by the group in any given income year. Broadly, losses can be treated in this way only if they could be transferred from the value donor to the real loss-maker, and to any other value donor to the real loss-maker, under the group loss transfer rules.

Note

This example is designed to illustrate the operation of the value donor concession. The choices made by the head company in this example are not purported to represent the best outcome for the group in every case where similar scenarios exist.

Example

Facts

HCo, ACo and CCo have constituted a wholly-owned group for a number of years. During this period, the group, through ACo, has owned 90% of BCo. ACo acquires the remaining 10% of BCo on 21 March 2001. There have been no changes in HCo's ownership or control. The group consolidates on 1 July 2002 and BCo's and CCo's losses (as set out in figure 1) are transferred to HCo, the head company of the group.

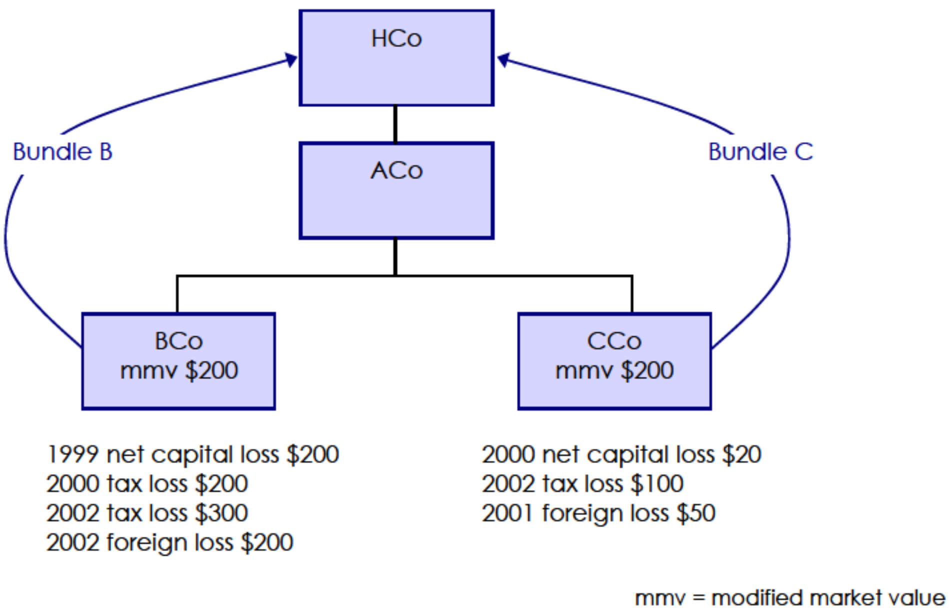
HCo chooses to:

- add to the modified market value of BCo by using an amount of CCo's modified market value for the purposes of working out the available fraction for the bundle of losses transferred from BCo, and
- treat the losses transferred from CCo as being included in the bundle of losses transferred from BCo for the purpose of determining their rate of utilisation.

The market value of the consolidated group at the joining time, ignoring losses and assuming a franking account balance of nil, is $400.

BCo has a 1999 net capital loss of $200, which is transferred to HCo. HCo chooses to utilise the loss over three years under section 707-350[1].

Figure 1: HCo and subsidiary members



[1] Section 707-350 of the *Income Tax (Transitional Provisions) Act 1997* provides a concession for the utilisation of certain company losses that were originally made for an income year ending on or before 21 September 1999 and transferred to the head company because the continuity of ownership and control tests were satisfied.

Calculation

Available fractions for losses transferred from BCo

For HCo to be able to add to BCo's modified market value by using a percentage of CCo's modified market value, certain conditions set out in subsections 707-325(1) and (2) must be met:

- First condition: The bundle of losses transferred from BCo must contain either a net capital loss or a tax loss and the loss is not utilised under section 707-350.
- Second condition: CCo, assuming it had made the loss, could have transferred it to HCo under Subdivision 707-A.
- Third condition: BCo could have transferred the loss to CCo under Subdivision 170-A or 170-B for an income year consisting of the trial year[2].

The amount that is added to BCo's modified market value is worked out in accordance with the formula contained in subsection 707-325(3):

$$\text{CCo's modified market value at initial transfer time} \times \text{Percentage chosen by HCo} \times \frac{\text{Total of BCo's Division 170 losses in bundle}}{\text{Total of BCo's non-foreign losses in bundle}}$$

The 'Total of BCo's Division 170 losses in bundle' are those losses that meet all of the conditions stated above. The 2002 tax loss of $300 is the only loss that meets all of these conditions.

The 1999 net capital loss of $200 and the 2000 tax loss of $200 do not meet the third condition. The losses were incurred before BCo became a part of a wholly-owned group with CCo. The 1999 net capital loss also fails to meet the first condition, because HCo chooses to utilise it over three years under section 707-350.

The 2002 foreign loss of $200 does not meet the first and third conditions (foreign losses cannot be transferred under Division 170).

The 'Total of BCo's non-foreign losses in bundle' means those losses that meet the first condition.

The 2000 tax loss of $200 and the 2002 tax loss of $300 both meets this condition.

[2] Generally, here the income year consists of the trial year. However, if the income year in which the loss is made started after the commencement of the trial year, the income year is a shorter period. → subsection 707-328(2)

Substituting the relevant amounts into the above formula and assuming that HCo chooses to use 100% of CCo's modified market value, the amount added to BCo's modified market value is:

$$\$200 \quad \times \quad 100\% \quad \times \quad \frac{\$300}{\$500} = \$120$$

Tax losses

The tax losses transferred from BCo will be utilised on the basis of the bundle having an available fraction of:

$$\frac{200 + 120}{400} = 0.800$$

Foreign loss

The utilisation of the foreign loss transferred from BCo is limited by the available fraction worked out as if section 707-325 never applied → subsection 707-325(9). Therefore, the foreign loss transferred from BCo will be utilised on the basis of the bundle having an available fraction of:

$$\frac{200}{400} = 0.500$$

Net capital loss

The utilisation of the 1999 net capital loss is not limited by any available fraction because HCo chooses to utilise it over three years under section 707-350.

Available fractions for losses transferred from CCo

The available fraction for the bundle of losses transferred from CCo is affected by subsection 707-325(8). The available fraction has to be worked out on the basis that CCo's modified market value was reduced by the amount worked out under subsection 707-325(3), i.e. the amount that was added to BCo's modified market value. This available fraction will apply to those tax and net capital losses that cannot be notionally transferred into BCo's bundle (see below).

As stated previously, HCo seeks to notionally transfer losses from CCo's bundle into BCo's bundle. Before it can do this, certain conditions contained in section 707-327 must be met:

- First condition: An amount of modified market value from CCo is added to the modified market value of BCo.
- Second condition: The loss is either a net capital loss or a tax loss and is not utilised under section 707-350.

- Third condition: The loss is transferred under Subdivision 707-A from CCo to HCo at the time when the consolidated group comes into existence.
- Fourth condition: If CCo has been a real loss-maker under a separate application of section 707-325, the loss must not be a loss that provides the basis for working out the available fraction under that application[3].
- Fifth condition: BCo, assuming it had made the loss, could have transferred it to HCo under Subdivision 707-A[4].
- Sixth condition: CCo could have transferred the loss to BCo (as well as to any other value donor to BCo) under Subdivision 170-A or 170-B for an income year consisting of the trial year[5].

Only the 2002 tax loss of $100 meets all of the above conditions.

The 2000 net capital loss does not meet the sixth condition. It was incurred before CCo became part of a wholly-owned group with BCo.

The 2001 foreign loss does not meet the second and sixth conditions (foreign losses cannot be transferred under Division 170).

Tax loss

The 2002 tax loss of $100 will be utilised on the basis of it being included in the bundle of losses transferred from BCo. For the purposes of utilising this loss, the bundle will have an available fraction of 0.800 (see above, 'Available fraction for losses transferred from BCo').

Net capital loss

As stated above, the utilisation of the 2000 net capital loss of $20 is affected by subsection 707-325(8). The available fraction for the bundle of losses transferred from CCo has to be worked out on the basis that CCo's modified market value was reduced by the amount that was added to BCo's modified market value. This amount was $120 (see above, 'Available fractions for losses transferred from BCo').

Therefore, the available fraction for the net capital loss transferred from CCo is:

$$\frac{200 - 120}{400} = 0.200$$

[3] In other words, the loss was not covered by paragraphs 707-325(1)(d) and (e) and subsections 707-325(2) in that application of section 707-325.

[4] This condition would also apply to any other value donors to BCo. In this example there are no other value donors.

[5] Generally, here the income year consists of the trial year. However, if the income year in which the loss is made starts after the commencement of the trial year, the income year is a shorter period. → subsection 707-328(2)

Foreign loss

The utilisation of the foreign loss transferred from CCo is limited by the available fraction worked out as if section 707-325 never applied → subsection 707-325(9). The foreign loss transferred from CCo will be utilised on the basis of the bundle having an available fraction of:

$$\frac{200}{400} = 0.500$$

Table 1: Summary of available fractions

Bundle	Transferred losses	Available fraction
B	$300 tax loss	0.800
	$200 tax loss	0.800
	$100 tax loss (from CCo's bundle)*	0.800
	$200 foreign loss	0.500
	$200 net capital loss**	N/A
C	$20 net capital loss	0.200
	$50 foreign loss	0.500

* This loss remains in CCo's loss bundle. It is treated as being in BCo's loss bundle for the purpose of determining the amount of the loss that can be utilised.

** The utilisation of the $200 net capital loss transferred from BCo is not limited by any available fraction because HCo chooses to utilise it over three years under section 707-350.

References

Income Tax Assessment Act 1997, Division 170

Income Tax Assessment Act 1997, 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, Chapter 9