Worked example

Adjusting available fraction – post-consolidation injection of capital

Description

Available fractions are adjusted to ensure they continue to approximate the proportion of the group's income that can be said to be generated by the relevant entity or group that transferred the loss. Certain post-consolidation events that increase the market value of the group will result in a downward adjustment to existing available fractions.

This example shows how to adjust the available fraction for an existing loss bundle in a consolidated group where there is an injection of capital into the group after consolidation.

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)
- market values → 'Market valuation guidelines', C4-1

Commentary

The available fraction for each loss bundle in a consolidated group is adjusted if the group's market value is increased as a result of either of these events:

- an injection of capital into the group or an associate of the group, or
- a non-arm's length transaction that involves the group or an associate of the group.

Under item 4 in the table in subsection 707-320(2) of the *Income Tax Assessment Act 1997*, an available fraction is adjusted using the following factor:

$$\frac{\text{market value of the group just before the event}}{\text{market value of the group just before the event + amount of the increase}}$$

The adjusted available fraction is worked out by multiplying the existing available fraction by the factor.

Example

Facts

HCo is the head company of a consolidated group that forms on 1 July 2002. LCo joins the group on 1 July 2003 and losses incurred by LCo are transferred to HCo. The available fraction for the bundle of losses transferred from LCo (bundle LCo) at the initial transfer time of 1 July 2003 is 0.400.

On 1 July 2004, the shareholders of HCo subscribe for an additional $10 million of shares in HCo. The market value of the group just before this capital subscription was $40 million. Assume this is the only event that requires an adjustment to be made to the available fraction for bundle LCo.

Calculation

The capital subscription of $10 million is a post-consolidation injection of capital into the group. The factor to adjust the available fraction for bundle LCo is:

$$\frac{\$40 \text{ million}}{\$40 \text{ million} + \$10 \text{ million}} = 0.8$$

The available fraction for bundle LCo changes to 0.320 on 1 July 2004, being the existing available fraction of 0.400 multiplied by the factor of 0.8:

$$0.400 \times 0.8 = 0.32$$

In determining the amount of transferred losses from bundle LCo that can be utilised in the income year 2005, the available fraction of 0.320 applies.

In determining the amount of transferred losses from bundle LCo that can be utilised in the income year 2004, the available fraction of 0.400 applies.

References

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

- item 4 in the table in subsection 707-320(2)
- subsection 707-325(4)

Explanatory Memorandum to the New Business Tax System (Consolidation) Bill (No.1) 2002, Chapter 8