Worked example

Adjusting available fraction – multiple adjustments under a scrip for scrip acquisition

Description

Available fractions are adjusted to ensure they continue to approximate the proportion of the consolidated group's income that can be said to be generated by the relevant loss entity or loss group.

This example shows how the available fraction for an existing loss bundle in a consolidated group is adjusted under items 3 and 4 of the table in subsection 707-320(2) of the *Income Tax Assessment Act 1997* (ITAA 1997) where the head company of another consolidated group joins the group as a result of a scrip for scrip acquisition.

Note

For more information on adjusting the available fraction see → 'Adjusting available fraction – another loss entity joins the group', C3-4-330 and 'Adjusting available fraction – post-consolidation injection of capital where head company issues shares in scrip for scrip merger', C3-4-342.

Commentary

The available fraction for an existing loss bundle can be adjusted under various adjustment items in subsection 707-320(2). This worked example focuses on adjustments required under adjustment items 3 and 4 where the head company of a consolidated group is acquired by another consolidated group via a scrip for scrip transaction.

Adjustment item 3 applies where losses in an incoming bundle or bundles are transferred to the acquiring head company.

Adjustment item 4 applies where a group's market value has increased as a result of an injection of capital or a non-arm's length transaction involving entities external to the group. A scrip for scrip transaction is considered to be an injection of capital → paragraphs 13, 59 and 92 of Taxation Ruling TR 2004/9.

Adjustment items 3 and 4 can both apply to the acquiring head company's existing loss bundles in a scrip for scrip acquisition, where a head company issues additional shares in itself as consideration for the acquisition of the membership interests in the head company of another consolidated group that has losses.

Subsection 707-320(3) stipulates that if a loss transfer under Subdivision 707-A triggers more than one adjustment event, the adjustment calculations are made in the same order as they appear in the table in subsection 707-320(2). Where there is an injection of capital, as in a scrip for scrip transaction, subsection

707-320(3) is not relevant in respect of adjustment item 4 because the loss transfer does not cause the capital injection event to occur.

Under a scrip for scrip transaction, the issue of new shares by the acquiring head company to the former shareholders of the target head company may occur at the same time as the acquisition of all the shares in the target head company by the acquiring consolidated group. This would mean that the time of transfer of incoming bundles of losses from the target head company to the acquiring head company would coincide with the timing of the capital injection.

In this situation, it is appropriate that adjustment item 4 is applied only in respect of pre-existing loss bundles held by the acquiring head company and before other adjustment items. This will ensure that the newly established available fraction for an incoming bundle of losses transferred from the target head company is not subject to an adjustment because of the injection of capital.

Example

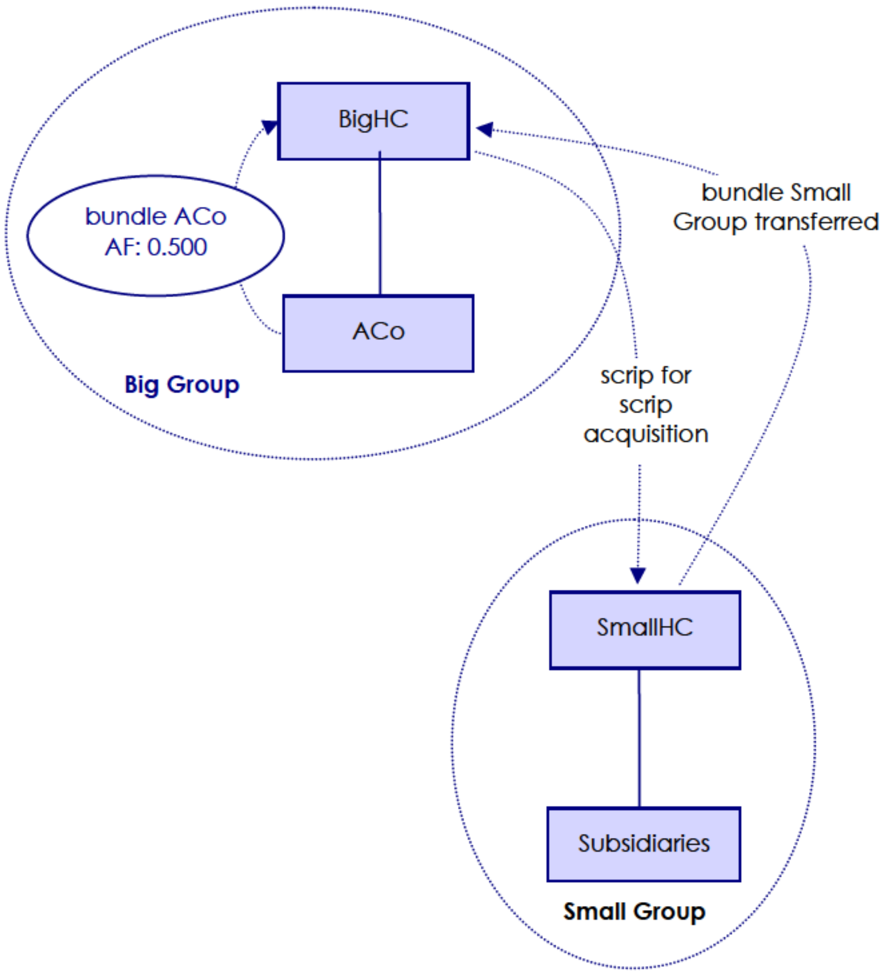
Facts

A consolidated group, Big Group, consists of head company BigHC and subsidiary member ACo. A loss made by ACo was transferred to BigHC when ACo joined the consolidated group. An available fraction of 0.500 is established for the bundle containing the loss (bundle ACo) at the initial transfer time.

Subsequently, Big Group, via a scrip for scrip transaction, acquires another consolidated group, Small Group, with SmallHC as head company. SmallHC has a group loss that is transferred to BigHC at the joining time.

This sequence of events is shown in figure 1. Big Group must establish an available fraction for the incoming loss bundle (SmallHC's group loss) and adjust the existing available fraction for bundle ACo under adjustment items 3 and 4.

Figure 1: Scrip for scrip acquisition of Small Group by Big Group



Calculation

Values ascertained at the relevant times are as follows:

Valuation	$
Market value of Big Group just before the capital injection	600
Market value of Small Group at the joining time	400
Market value of the new joined group (including the market value of Small Group) at the joining time	1,000

Step 1 – Apply adjustment item 4 to the available fraction for bundle ACo by multiplying it by the relevant factor (in this case the amount of the increase is the same as the market value of Small Group at the joining time)

0.500 x [600/(600 + 400)] = 0.300

Step 2 – Establish the available fraction for the group loss bundle transferred from Small Group

400/1000 = 0.400

(This available fraction does not get adjusted under item 4 in subsection 707-320(2) because BigHC did not hold this group loss bundle before the capital injection event.)

Step 3 – Apply adjustment item 3 to the available fraction for bundle ACo by multiplying it by the relevant factor

0.300 x (1 – 0.400) = 0.180

The available fractions for the new joined group's bundles of losses are as follows:

Bundles	AF
Small Group (group loss bundle)	0.400
ACo	0.180

References

Income Tax Assessment Act 1997, subsections 707-320(2), 707-320(3)

Taxation Ruling TR 2004/9

Revision history

Section C3-4-360 first published 15 April 2010.

Proposed changes to consolidation

Proposed changes to consolidation announced by the Government are not incorporated into the *Consolidation reference manual* until they become law. In the interim, information about such changes can be viewed at:

- **http://assistant.treasurer.gov.au** (Assistant Treasurer's press releases)
- **www.treasury.gov.au** (Treasury papers on refinements to the consolidation regime).