Worked example

Amount of transferred losses that can be utilised – foreign loss component of a tax loss

Description

This example shows the application of the available fraction method in determining the limits for utilisation of transferred losses where there is a foreign loss component of a tax loss.

Note

For more information about the available fraction method → 'Treatment of losses', C3-1; 'Consolidation loss provisions', C3-2-110; 'Amount of transferred losses that can be utilised', C3-4-410.

Commentary

Under changes made to the tax treatment of foreign losses:

- The foreign loss quarantining rules have been repealed. Foreign losses are not quarantined from domestic assessable income (or from assessable foreign income of a different class).
- Resident taxpayers, including the head company of a consolidated group, can offset domestic losses against assessable foreign income.
- Transitional rules provide for the conversion of past foreign losses to a tax loss with a limit on utilisation in the four year transitional period.
- Special transitional rules apply to consolidated groups.

These changes apply from the first income year starting on or after 1 July 2008 (the commencement year).

Generally, unrecouped foreign losses for an earlier income year are grouped together and converted to a tax loss.[1] This tax loss will have a foreign loss component, being the amount of the convertible foreign loss for that income year.

If an entity would otherwise have a tax loss for that income year, its tax loss is the sum of that amount plus the convertible foreign loss.

The available fraction method does not limit the utilisation of the foreign loss component of a converted tax loss in the first four years beginning with the

[1] Only overall foreign losses that were originally made in any of the most recent 10 income years (disregarding the operation of section 707-140 of the ITAA 1997) ending before the start of the commencement year are eligible to be converted to tax losses → subsection 770-5(2), IT(TP)A. Furthermore, certain reductions are required to each overall foreign loss in relation to a class of assessable foreign income in accordance with the method statement in section 770-10 of the IT(TP)A.

commencement year. Instead, an annual deduction limit in section 770-30 of the IT(TP)A will apply.[2] After the four year transitional period, any remaining foreign loss component is utilised subject to the available fraction method.

For the purpose of working out how much of the remaining tax losses in a bundle the head company can utilise in an income year in the four year transitional period, the head company applies the available fraction for the bundle to income remaining after deductions for all foreign loss components (both group and transferred). → subsection 770-105(3), IT(TP)A

Example

Facts

A consolidated group is working out its taxable income for the 2008-09 income year.

The group's carry forward transferred losses at the start of the 2008-09 income year are set out in table 1 and its income and gains for the income year are shown in table 2. Assume all losses were transferred to the head company at the same joining time, namely the date of consolidation 1 July 2003.[3]

Assume that the loss recoupment tests are satisfied in respect of all the losses sought to be deducted.

Table 1: Transferred losses

Loss bundle	Amount ($'000)	Sort	Available fraction
A	1,000 300	Tax loss Foreign loss	0.6
B	500 200	Tax loss Foreign loss	0.4

Table 2: Group income and gains for 2008-09 income year

Income/gains	Amount ($'000)
Other assessable income (domestic and foreign)	1,600 (deductions are nil)

[2] Subsection 770-105(2) of the IT(TP)A. The annual deduction limit does not apply where the sum of all convertible foreign losses is $10,000 or less. → section 770-15, IT(TP)A

[3] These losses are therefore taken to have been made in the 2003-04 income year by the operation of subsection 707-140 of the ITAA 1997.

Calculation

1. Determine deduction limit for the foreign loss component of tax losses

Convertible foreign loss amounts of the relevant tax losses are aggregated to arrive at a starting total, which is then divided into 5 equal portions. The head company can use a maximum of one portion in the commencement year → subsection 770-30(1), IT(TP)A.

The deduction limit for the foreign loss component is shown in table 3.

Table 3: Deduction limit for foreign loss component of tax losses

Loss bundle	Convertible foreign loss ($'000)	Starting total (sum of convertible foreign losses) ($'000)	*Multiplied by* 1/5	*equals* allowable deduction ($'000)
A	300	500	100	100
B	200			

2. Determine limits for utilisation of transferred tax losses

Step 1: Work out the categories of group income or gains – subsection 707-310(3)

Table 4: Categories of group income or gains (step 1)

Column 1 Income or gains	Gross amount ($'000)	*Less:* allowable deductions/ reductions ($'000)	*Less:* group/ concessional losses of that kind ($'000)	Column 2 Income/ gains available for bundle ($'000)
Other assessable income	1,600	100	–	1,500

The head company chooses that the $100,000 deduction for foreign loss component comprises $60,000 from bundle A and $40,000 from bundle B, being 1/5th of the starting amount for each bundle.

Step 2: Calculate the fraction of the income/gains that is attributable to each bundle – subsection 707-310(3)

Table 5: Fraction of income/gains attributable to each bundle (step 2)

Column 1 income or gains	Loss bundle	Column 2 income/gains available for bundle ($'000)	*Multiplied by*: available fraction (AF)	AF amount for the bundle ($'000)
Other assessable income	Bundle A	1,500	0.6	900
	Bundle B	1,500	0.4	600

Step 3(a): Work out a notional taxable income for bundle A – subsection 707-310(2)

Table 6: Notional taxable income – bundle A

Assessable income	($'000)	Deductions	($'000)
Other assessable income	900	Transferred tax loss	900
Total	**900**	**Total**	**900**

The notional taxable income is nil ($900,000 – $900,000).

The transferred tax loss amount of $900,000 is the limit for utilisation of bundle A's transferred loss when determining the actual taxable income for the group.

Step 3(b): Work out a notional taxable income for bundle B – subsection 707-310(2)

Table 7: Notional taxable income – bundle B

Assessable income	($'000)	Deductions	($'000)
Other assessable income	600	Transferred tax loss	500
Total	**600**	**Total**	**500**

The (notional) taxable income is $100,000 ($600,000 – $500,000).

The transferred tax loss amount of $500,000 is the limit for utilisation of bundle B's transferred loss when determining the actual taxable income for the group.

4. Determine group's actual taxable income

Table 8: Taxable income

Assessable income	($'000)	Deductions	($'000)
Other assessable income	1,600	Transferred tax loss – foreign loss component	100
		Transferred tax loss – bundle A	900
		Transferred tax loss – bundle B	500
Total	**1,600**	**Total**	**1,500**

The group's taxable income is $100,000 ($1,600,000 – $1,500,000).

Transferred losses carried forward are:

- transferred tax loss (bundle A): $100,000 ($1,000,000 – $900,000)
- transferred tax loss (bundle B): $0 ($500,000 – $500,000)
- foreign loss component of a converted tax loss: $400,000 (comprising $240,000 for bundle A and $160,000 for bundle B)

Note that in the fourth income year after 2008-09, the undeducted amount of the foreign loss component is utilised under the available fraction method using the available fractions of 0.6 and 0.4 for bundles A and B respectively (subject to any adjustments in the meantime).[4]

[4] The purpose of section 770-1 of the IT(TP)A is to permit a taxpayer to convert, to a tax loss, unrecouped overall foreign losses such that they can be deducted, subject to a drip-feed method, from assessable income for income years starting on or after the commencement year. It follows that any remaining foreign loss component after the transitional period has expired is deductible subject to the available fraction calculated in respect of tax losses contained in the respective bundles (in this case, $100,000 plus any remaining foreign loss component from the deduction limit during the previous four years in the transitional period). This requires tracking of the utilisation of each loss while subject to the drip-feed approach such that loss balances can be established at the expiry of the transitional period.

References

Income Tax Assessment Act 1997, Subdivision 707-C

Income Tax (Transitional Provisions) Act 1997, Subdivisions 770-A and 770-B

Explanatory Memorandum to the New Business Tax System (Consolidation) Bill (No. 1) 2002, Chapters 8 and 9

Explanatory Memorandum to the Tax Laws Amendment (2007 Measures No.4) Bill 2007, Chapter 1

Revision history

Section C3-4-560 first published 30 June 2009.

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).

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