Worked example

Apportioning the use of transferred losses in formation year

Description

The use of transferred losses is apportioned where a consolidated group forms part-way through the head company's income year.

This example shows an apportionment method for the formation year as an alternative to a strict pro rata approach.

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)
- apportioning the use of transferred losses → 'Apportioning the use of transferred losses', C3-4-610 (worked example)

Commentary

Section 707-335 limits the utilisation of losses in a bundle when losses are transferred to the head company after the start of the income year. This ensures that a subsidiary's losses are only offset against income generated by the group after the subsidiary became a member of the group[1].

The apportionment rule in section 707-335 is drafted so that if apportionment is required the group cannot use more of its transferred losses than is reasonable having regard to the matters listed in subsection 707-335(3). The matters provide that:

- apportionment is consistent with the available fraction method of determining the use of transferred losses → section 707-310
- the number of days the head company holds the bundle in the income year is taken into account[2]
- the number of days the available fraction has a particular value is taken into account, and
- any other relevant matters are taken into account.

In the formation year, a relevant matter can be that pre-formation period income is only derived by the head company as a single entity, whereas post-formation income is derived by all members of the group. This means

[1] This apportionment does not apply to losses transferred by a company to itself in its capacity as a head company → 'Apportioning the use of the head company's own losses', C3-4-620.

[2] Referred to as the 'transferee's loss-holding period'.

apportionment on a strict 'number of days' basis may not properly reflect group income generated in the post-formation period.

The formula below determines the fraction of head company income attributable to the post-formation period. This fraction is multiplied by the 'full-year limit' of the loss bundle[3] to give the utilisation limit for that particular bundle in the formation year.

The formula is based on income (net of deductions) being earned uniformly throughout the formation year by the head company alone as a proportion of income (net of deductions) earned by all group members. Whether the formula is appropriate to use in a particular case can depend on the economic position of the head company and group during the formation year. For example, an injection of capital into the group that significantly changes the head company's contribution to group profitability could result in the formula being inappropriate.

The limit of transferred losses using the formula must be 'reasonable' to satisfy section 707-335.

The formula is:

$$\text{Fpost} = \frac{1}{1 + [\text{AF(HC)} \times \text{Dpre/Dpost}]}$$

where:

Fpost is the fraction of head company income attributable to the post-formation period

AF(HC) is the available fraction as if the head company had transferred losses to itself at consolidation

Dpre is the number of days in the pre-formation period

Dpost is the number of days in the post-formation period

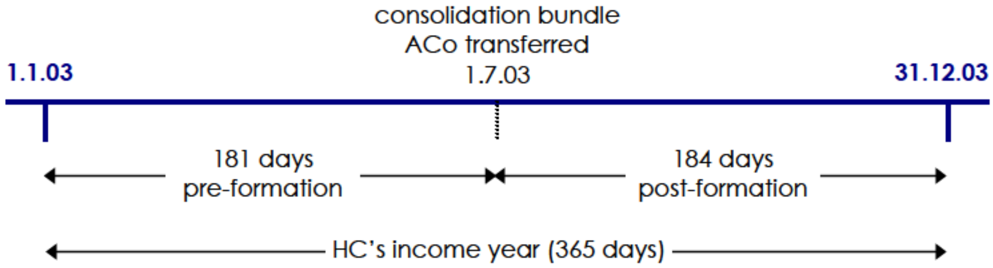
Example

Facts

A head company (HC) has a substituted accounting period (income year) ending on 31 December. It forms a consolidated group on 1 July 2003, part-way through its income year. A prior year tax loss of $6,000 is transferred to HC from subsidiary member ACo at the formation time. The loss is transferred in bundle ACo. An available fraction of 0.750 is established for bundle ACo at the initial transfer time of 1 July 2003.

[3] The 'full-year limit' is the limit worked out under section 707-310 ignoring the application of section 707-335.

Figure 1: Formation year



HC's transferred loss for the 2003 income year is shown in table 1.

Table 1: HC transferred losses

Loss bundle	Unused transferred losses
Bundle ACo	$6,000 tax loss (not film)

HC satisfies the recoupment tests for utilisation of the transferred loss in the 2003 income year.

In the 2003 income year HC generates $26,300 of assessable income and its deductions in relation to that income are $15,700.

HC as a single entity has contributed to group income (net of deductions) at the same rate throughout the formation year ended 31 December 2003. Accordingly, although HC did not transfer a loss to itself at consolidation, it is still necessary to calculate an available fraction for HC as if it had transferred a loss to itself at consolidation. This is the 'AF(HC)' component in the formula on page 2. If HC had transferred a loss to itself at group formation, the available fraction calculated for bundle HC at that time would have been 0.075.

Calculation

A. Apply the three-step available fraction method

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

Table 2: Categories of group income or gains (step 1)

Category of income or gains	Gross amount ($)	*Less:* other allowable deductions/ reductions ($)	*Less:* group/ concessional losses of that kind($)	Income/ gains available for the bundle ($)
Other assessable income	26,300	15,700	–	10,600

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

Table 3: Fraction of income/gains attributable to each bundle (step 2)

Category of income or gains	Loss bundle	Step 1 amount	*Multiplied by:* available fraction (AF)	*Multiplied by:* apportionment fraction	AF amount for the bundle
Other assessable income	Bundle ACo	$10,600	0.750	0.931	$7,401

The apportionment fraction is the fraction of head company income attributable to the post-formation period as calculated by the formula:

$$\text{Fpost} = \frac{1}{1 + [0.075 \times 181/184]} = 0.931$$

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

Table 4: Taxable income (step 3)

Assessable income	$	Deductions/losses	$
Other assessable income	7,401	Transferred tax loss	6,000
Total	**7,401**	**Total**	**6,000**

The (notional) taxable income for bundle ACo is $1,401 ($7,401 – $6,000).

All of the $6,000 tax loss in bundle ACo can be used by HC when it determines its actual taxable income for the 2003 income year.

B. Determine group's actual taxable income

Table 5: Taxable income

Assessable income	$	Deductions/losses	$
Other assessable income	26,300	Deductions	15,700
		Transferred tax losses (bundle ACo)	6,000
Total	**26,300**	**Total**	**21, 700**

The group's taxable income is $4,600 ($26,300 – $21,700).

As there are no losses remaining in bundle ACo, it now ceases to exist (by the operation of subsection 707-315(3)).

References

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

- section 707-310
- section 707-335
- section 707-315

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

Revision history

Section C3-4-630 first published 28 May 2003.

Further revisions are described below.

Date	Amendment	Reason
10.12.04	Clarify necessity for HC to calculate an available fraction for itself to use the formula on page 2, even though HC did not transfer a loss at consolidation.	Clarification.

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).