Worked example

Transfer of tax losses from head company of consolidated group to Australian branch of a foreign bank

Description

Amendments to Division 170 of the *Income Tax Assessment Act 1997* ensure that transfers of tax losses and net capital losses occur only in limited circumstances. Loss transfers continue to be permitted between members of the same wholly-owned group where one of the parties to the transfer is an Australian branch of a foreign bank, and the other is either the head company of a consolidated group, the head company of a MEC group, or a non-member of a consolidatable group[1].

This example shows how a loss that was transferred at the joining time to the head company from a subsidiary member is subsequently transferred post-consolidation to an Australian branch of a foreign bank within the same wholly-owned group.

Commentary

Although an Australian branch of a foreign bank was eligible to be part of a wholly-owned group for the purpose of loss transfers[2] under Division 170 prior to the amendments, it is not eligible to be a member of a consolidated or consolidatable group under section 703-15. Accordingly, Division 170 was retained and amended to ensure that loss transfers involving an Australian branch of a foreign bank could continue to be made in certain circumstances.

While company groups that do not choose to consolidate may not transfer losses, modifications to Subdivisions 170-A and 170-B enable loss transfers involving losses made by either a branch or a company prior to consolidation to continue after consolidation provided certain conditions are met. Their treatment depends in part on whether the transfer is from a head company of a consolidated group to a branch or from a branch to a head company.

Losses incurred after consolidation are still eligible to be transferred between a company and a foreign bank branch under Division 170 without modification.

[1] Generally, the amendments to Division 170 apply for income years or non-membership periods starting after 30 June 2003. For companies joining a consolidated or MEC group, the amendments apply for income years or non-membership periods starting on or after the date of consolidation in certain circumstances.

[2] Sections 160ZZZG (tax losses) and 160ZZZH (net capital losses) of the *Income Tax Assessment Act 1936*.

Transfer of previously transferred losses from a head company to a foreign bank branch

Losses that have been transferred to the head company of a consolidated group are able to be transferred to a foreign bank branch if all the conditions of Division 170 as amended are satisfied. The amendments modify the conditions for the relationship test and the utilisation test.

Relationship test

Generally, each loss owner, while it owned the loss, is required to have been in existence and a member of the same wholly-owned group as the branch[3]. That is:

- the original loss company must be a member of the same wholly-owned group as the branch during the loss year while both are in existence and until the loss is transferred to the head company of the consolidated group, and
- the head company and the branch must maintain the same wholly-owned group relationship from the time the loss is transferred to the head company until the end of the income year in which the loss is transferred to the branch (the deduction year) or while they are both in existence during that period.

There is no requirement that the original loss-maker, or any later 'owner' of the loss, be a member of the consolidated group at the time the head company transfers the loss to the branch.

Utilisation test (foreign bank branch[4])

Passing the utilisation test in Division 170 requires that the branch would not be prevented by Divisions 165 or 175 from deducting or applying the loss if the branch had incurred the loss in the original loss year[5]. Since a head company is taken to have incurred a transferred loss for the income year of transfer (under section 707-140), a modification provides that the branch tests its ability to utilise the loss on the assumption that it made the loss in the original loss year, instead of the head company's loss year.

After the head company utilises its transferred losses for an income year in accordance with the limits determined in Subdivision 707-C, any amount of transferred losses remaining in a loss bundle are available in full for transfer to the foreign bank branch. This is also relevant for losses whose utilisation is limited by section 707-350 (concessional losses). Such transfers are available even where the head company's final tax position is such that it has a taxable

[3] Sections 170-32 and 170-132.

[4] The utilisation test also applies to the head company of the consolidated group (it is necessary to consider Subdivision 707-B when applying the utilisation test to the head company).

[5] Subsections 170-15(3) and 170-115(3).

income, or has excess exempt income remaining. The amount able to be transferred is limited by the amount the head company would carry forward to the next income year and the amount the foreign bank branch can utilise[6].

Ordering

A head company transferring losses to a branch must do so in the following order[7]:

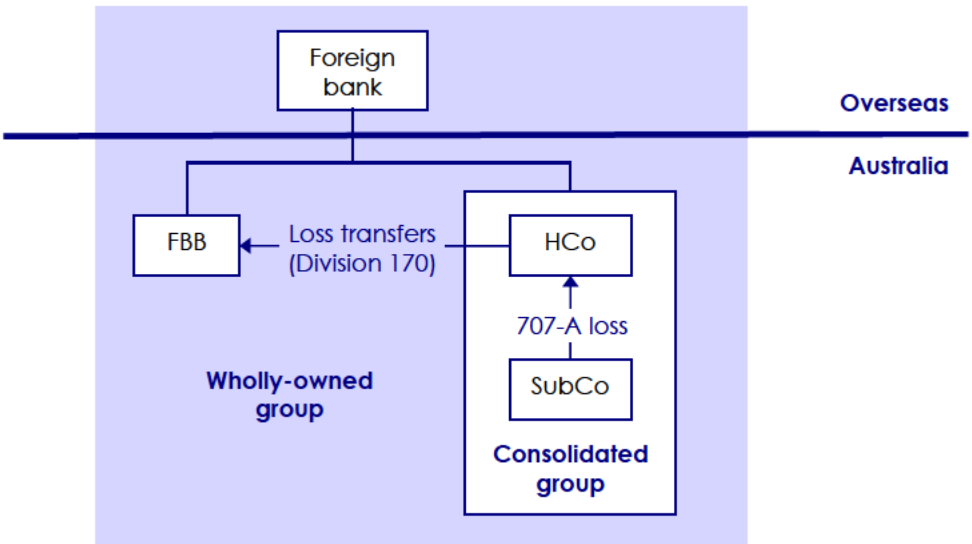
1. group losses
2. COT concessional losses:
   - these are transferred losses that are utilised in accordance with the transitional provisions in section 707-350, and
3. other transferred losses:
   - these are losses transferred under Subdivision 707-A whose limit is calculated under Subdivision 707-C.

Example

Facts

A wholly-owned group controlled by a foreign bank (figure 1) consists of an Australian branch of a foreign bank (FBB), a head company of a consolidated group (HCo) and a subsidiary member (SubCo). The consolidated group formed on 1 July 2002. A pre-consolidation tax loss of $500 was transferred from SubCo to HCo at the joining time. This tax loss was originally incurred by SubCo during the income year ended 30 June 2000 and now forms a loss bundle consisting of one tax loss with an available fraction. For the income year ended 30 June 2003, HCo also incurs a group tax loss of $400.

Figure 1: Structure of wholly-owned group



[6] Sections 170-45 and 170-145.

[7] Subsections 170-55(3) to (5) and subsections 170-155(2) to (4) of the *Income Tax Assessment Act 1997*; sections 170-55 and 170-155 of the *Income Tax (Transitional Provisions) Act 1997*.

During the income year ended 30 June 2004, HCo has other assessable income of $1,000 and deductions relating to that income of $700. For the year ended 30 June 2004, HCo's taxable income is reduced to nil by its carry-forward group tax loss [$1,000 – ($700 in deductions + $300 in carry-forward group tax loss) = nil]. This leaves $100 of the group tax loss remaining to be carried forward to the 2005 income year ($400 – $300 = $100). HCo still has the Subdivision 707-A transferred tax loss of $500 to be carried forward to the 2005 income year.

For the year ended 30 June 2004, HCo seeks to transfer its carried forward group tax loss of $100 and its carried forward Subdivision 707-A transferred tax loss of $500 to FBB.

FBB, HCo and SubCo have all been part of the same wholly-owned group since 1 July 1995, with no changes to the underlying membership interests since that time.

Calculation

Before it can transfer any amount of its Subdivision 707-A tax loss to FBB, HCo must first determine whether it can transfer any of its unused group tax loss to FBB. On the assumption that the requirements in Division 170 are satisfied, HCo's group tax loss of $100 will be available for transfer to FBB for utilisation against FBB's assessable income or exempt income.

For HCo to transfer its Subdivision 707-A transferred tax loss to FBB under Division 170, the modified conditions in Subdivision 170-A must be satisfied. The modified tests that must be met before a transfer can take place are as follows.

Relationship test

To meet the relationship test, SubCo and FBB must have been members of the same wholly-owned group during the loss year and until the loss was transferred to HCo. HCo and FBB must have maintained the same wholly-owned group relationship from the time the loss was transferred to HCo from SubCo until the end of the income year in which the loss was transferred to FBB (the deduction year).

Table 1 lists the entity relationships and the time periods that they must have maintained these relationships to pass the test.

Table 1: Entity relationships

Relationship	Time period	Relationship maintained
SubCo and FBB	1 July 1999 to 30 June 2002	Yes
HCo and FBB	1 July 2002 to 30 June 2004	Yes

The relationship test has been passed because the wholly-owned group relationship between FBB, HCo and SubCo has been maintained throughout the period consisting of the loss year to the end of the deduction year.

Utilisation test (foreign bank branch)

Based on the modified utilisation test, FBB is taken to have incurred the transferred tax loss for the income year for which SubCo incurred it. This means that the utilisation test (application of Divisions 165 and 175), as it applies to the transferred tax loss that is to be transferred from HCo to FBB in accordance with the requirements of Division 170, applies from the time of the original loss year (that is, from 1 July 1999).

Passing the test requires that FBB would not be prevented by Divisions 165 or 175 from deducting that loss had the loss been incurred by FBB, instead of SubCo, during the income year ended 30 June 2000.

As there are no changes to the underlying membership interests within the wholly-owned group from the time the loss is first incurred by SubCo, FBB would be capable of utilising the loss because it would satisfy the modified test for utilisation[8].

The transferred loss is able to be transferred to FBB for the year ended 30 June 2004 after the group loss has been transferred. The group loss and the transferred loss can be transferred to the extent that FBB can deduct the loss against its assessable income or exempt income.

References

Income Tax Assessment Act 1936, sections 160ZZZG, 160ZZZH

Income Tax Assessment Act 1997:

- Division 165
- Division 170
- Subdivision 170-A
- Subdivision 170-B
- section 703-15
- Subdivision 707-A
- Subdivision 707-C
- section 707-140

Income Tax (Transitional Provisions) Act 1997, sections 170-55, 170-155, 707-350

Explanatory Memorandum to the New Business Tax System (Consolidation and Other Measures) Bill (No. 1) 2002, Chapter 5

[8] HCo also satisfies the utilisation tests that would apply to it under Division 170.