

Worked example

Late loss transfers under Subdivision 170-A – consolidation and the Commissioner’s discretion

Description This example shows that ‘late’ loss transfer agreements can be made, where the Commissioner has granted an extension of time, even though a consolidated group has formed.

Commentary The provisions of Subdivision 170-A of the *Income Tax Assessment Act 1997* (ITAA 1997) allow tax losses to be transferred within a wholly-owned group of companies.¹ Generally, loss transfer agreements must be made on or before the date of lodgment of the income company’s income tax return. However, a ‘late’ loss transfer agreement can be made where the Commissioner exercises the discretion provided for in paragraph 170-50(2)(d) of the ITAA 1997.

In exercising the discretion to provide an extension of time the Commissioner is guided by administrative law principles. These principles are discussed in Taxation Ruling TR 98/12.²

In some cases, the income company and loss company will have joined a consolidated group by the time the request for an extension of time is received by the Commissioner. The fact that either company has joined a consolidated group will not, of itself, prevent the favourable exercise of the discretion.

Subdivision 707-A of the ITAA 1997

For the purposes of income years ending after the joining time, subsection 707-140(1) of the ITAA 1997 deems the head company to have made a transferred loss for the income year in which the transfer occurs. The joining entity is also taken not to have made the loss for the income year in which it was actually made. Subsection 707-140(2) of the ITAA 1997 provides that the head company may utilise the transferred loss in the income year of transfer. These provisions ensure that the loss can be used by the head company for all income years ending after the transfer time.

Although the head company is deemed to have made the loss, the joining entity can still be a loss company (as defined in Subdivision 170-A) in respect of income years³ ending before the joining time. As such, Subdivision 170-A loss transfer agreements can still be effective in respect of pre-joining time

¹ Subdivision 170-A has been significantly modified, generally with effect from 1 July 2003. Transfers are now allowed only where one of the parties to the transaction is an Australian branch of a foreign bank → ‘Transfer of tax losses under Subdivision 707-A’ C3-5.

² Specifically paragraphs 17-20 and 81-94.

³ Including non-membership periods, as defined by section 701-30 of the ITAA 1997, ending just before the joining time.

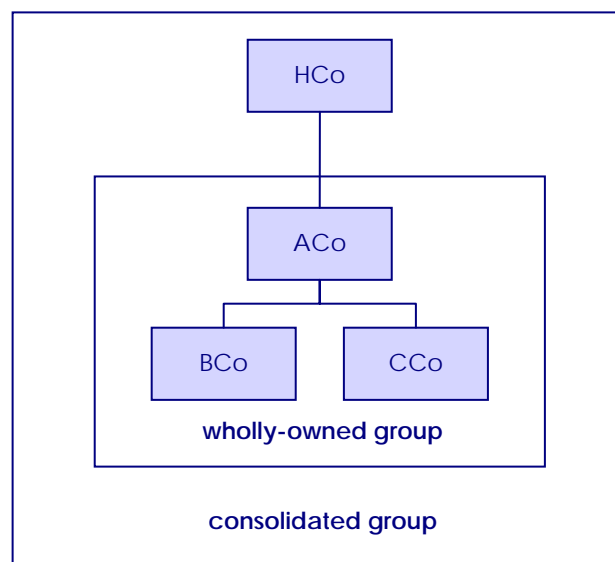
periods, even if they are made after the joining time, when both the loss company and income company may be members of a consolidated group.

All valid loss transfer agreements under Subdivision 170-A, including those made after the joining time, will affect the quantum of losses transferred to the head company under Subdivision 707-A. Depending on the circumstances, amendments to assessments may be required for income years ending before and after the joining time. For example, the head company may have already deducted a transferred tax loss that exceeds the quantum actually transferred to it under Subdivision 707-A taking into account a late loss transfer agreement.

Example

Facts A consolidated group forms on 1 July 2003 consisting of HCo, ACo, BCo and CCo.

Figure 1: HCo group



ACo, BCo and CCo have constituted a wholly-owned group⁴ for a number of years. The companies transferred tax losses within that group under Subdivision 170-A for the 2003 income year.⁵ HCo is not a member of the wholly-owned group in respect of the 2003 income year as it acquired 100% of the membership interests in ACo during the income year. Unused tax losses are transferred to HCo under Subdivision 707-A at the joining time.

⁴ As defined in section 975-500 of the ITAA 1997.

⁵ The income year prior to joining the HCo group.

Calculation

The following three scenarios illustrate how the quantum of losses transferred under Subdivision 707-A can change with the granting of the Commissioner's discretion to allow late loss transfer agreements.

Scenario 1: Reduction in the loss of a loss company

The taxable income/loss positions for ACo, BCo and CCo for the 2003 income year, prior to loss transfers, are shown in table 1.

Table 1: Taxable income/loss for the 2003 income year (before loss transfers)

| Company | Taxable position | Amount |
|---------|------------------|--------|
| ACo | Loss | \$300 |
| BCo | Loss | \$200 |
| CCo | Income | \$250 |

Under a valid loss transfer agreement, ACo transfers \$250 of its 2003 tax loss to CCo.

Unused tax losses are transferred to HCo at the joining time, as shown in table 2.

Table 2: Transferred losses (initial position)

| Loss bundle | Unused transferred losses | Sort |
|-------------|---------------------------|----------|
| Bundle ACo | \$50 | Tax loss |
| Bundle BCo | \$200 | Tax loss |

During the 2005 income year ACo asks the Commissioner to amend its 2003 assessment. The amendment reduces its tax loss for the 2003 income year from \$300 to \$200. Pursuant to subsection 170-65(1) of the ITAA 1997, only \$200 is taken to have been transferred to CCo under the loss transfer agreement. ACo does not have any tax loss that can be transferred to HCo under Subdivision 707-A.

A request is made to enter into a late loss transfer agreement between BCo and CCo. The agreement specifies that \$50 of BCo's 2003 tax loss be transferred to CCo, with the effect that CCo's taxable income is reduced to nil.

Provided the Commissioner's discretion is exercised⁶ to allow the late loss transfer agreement, the corrected position is that a tax loss is transferred from BCo to HCo at the joining time. The transferred loss is shown in table 3.

⁶ As per the principles outlined in Taxation Ruling TR 98/12.

Table 3: Transferred losses (corrected position)

| Loss bundle | Unused transferred losses | Sort |
|-------------|---------------------------|----------|
| Bundle BCo | \$150 | Tax loss |

If HCo has lodged a 2004 income tax return and has utilised an amount of tax losses not reflecting this corrected position,⁷ its assessment would need to be amended accordingly.

Scenario 2: Increase in the income of the income company

The taxable income/loss positions for ACo, BCo and CCo for the 2003 income year, prior to loss transfers, are shown in table 4.

Table 4: Taxable income/loss for the 2003 income year (before loss transfers)

| Company | Taxable position | Amount |
|---------|------------------|--------|
| ACo | Loss | \$300 |
| BCo | Loss | \$200 |
| CCo | Income | \$250 |

Under a valid loss transfer agreement, ACo transfers \$250 of its 2003 tax loss to CCo.

Unused tax losses are transferred to HCo at the joining time, as shown in table 5.

Table 5: Transferred losses (initial position)

| Loss bundle | Unused transferred losses | Sort |
|-------------|---------------------------|----------|
| Bundle ACo | \$50 | Tax loss |
| Bundle BCo | \$200 | Tax loss |

During the 2005 income year CCo asks the Commissioner to amend its 2003 assessment. The amendment would have the effect of increasing CCo's taxable income for the 2003 income year, prior to any further loss transfers, from nil to \$100.

A request is made to enter into a further loss transfer agreement between ACo and CCo. The agreement specifies that \$50 of ACo's 2003 tax loss be transferred to CCo.

⁷ i.e. an amount thought to have been transferred from ACo or an amount exceeding the actual amount transferred from BCo.

A request is also made to enter into a late loss transfer agreement between BCo and CCo. The agreement specifies that \$50 of BCo's 2003 tax loss be transferred to CCo.

These late loss transfer agreements would maintain CCo's taxable income at nil.

Provided the Commissioner's discretion is exercised to allow the further loss transfer agreement and the late loss transfer agreement, the corrected position is that a tax loss is transferred from BCo to HCo at the joining time. The transferred loss is shown in table 6.

Table 6: Transferred losses (corrected position)

| Loss bundle | Unused transferred losses | Sort |
|-------------|---------------------------|----------|
| Bundle BCo | \$150 | Tax loss |

If HCo has lodged a 2004 income tax return and has utilised an amount of tax losses not reflecting this corrected position, its assessment would need to be amended accordingly.

Scenario 3: Increase in the loss of a loss company

The taxable income/loss positions for ACo, BCo and CCo for the 2003 income year, prior to loss transfers, are shown in table 7.

Table 7: Taxable income/loss for the 2003 income year (before loss transfers)

| Company | Taxable position | Amount |
|---------|------------------|--------|
| ACo | Loss | \$30 |
| BCo | Loss | \$200 |
| CCo | Income | \$250 |

Under valid loss transfer agreements, ACo and BCo each transfer their 2003 tax losses to CCo. CCo therefore has a taxable income of \$20 for the 2003 income year.

As all losses have been utilised for an income year ending before the joining time, there are no losses transferred to HCo on 1 July 2003.

During the 2005 income year ACo asks the Commissioner to amend its 2003 assessment. The amendment results in ACo having its tax loss for the 2003 income year increased from \$30 to \$70.

A request is made to enter into a further loss transfer agreement between ACo and CCo. The agreement specifies that \$20 of ACo's 2003 tax loss be transferred to CCo, with the effect that CCo's taxable income is reduced to nil.

Provided the Commissioner's discretion is exercised to allow the further loss transfer agreement, the corrected position is that a tax loss is transferred from ACo to HCo at the joining time. The transferred loss is shown in table 8.

Table 8: Transferred losses

| Loss bundle | Unused transferred losses | Sort |
|-------------|---------------------------|------|
| Bundle ACo | \$20 | Tax |

If HCo has lodged a 2004 income tax return prior to the discretion being exercised, and is able (and chooses) to utilise an amount of the transferred loss in the 2004 income year, its assessment would need to be amended accordingly.

References

Income Tax Assessment Act 1997, Subdivision 170-A; as in effect before amendments introduced by *New Business Tax System (Consolidation) Act (No. 1) 2002* (No. 68 of 2002)

Income Tax Assessment Act 1997:

- paragraph 170-50(2)(d)
- subsection 170-65(1)
- section 701-30
- Subdivision 707-A
- subsections 707-140(1) and (2)
- section 975-500

Taxation Ruling TR 98/12

Revision history

Section C3-5-130 first published 27 January 2005.

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).