


LCR 2017/D6 - The business continuity test - carrying on a similar business

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The business continuity test – carrying on a similar business

Relying on this Guideline

This Guideline describes how the Commissioner will apply amendments made by the Treasury Laws Amendment (2017 Enterprise Incentives No. 1) Bill 2017. If it is enacted without amendment, this Guideline will be finalised and become a public ruling.

If you rely on this Guideline in good faith, you will not have to pay any shortfall tax, penalties or interest in respect of matters covered by the Guideline if it does not correctly state how a relevant provision applies to you.

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What this Guideline is about

1. The ‘business continuity test’, recently introduced into the company loss rules,¹ retains the existing ‘same business test’² and introduces a new ‘similar business test’.³ Under this new test, a company will be able to utilise tax losses made from carrying on a business against income derived from carrying on a similar business following a change in ownership or control.

¹ Subdivision 165-E of the *Income Tax Assessment Act 1997* (ITAA 1997), introduced by Schedule 1 to the Treasury Laws Amendment (2017 Enterprise Incentives No. 1) Bill 2017. All legislative references in this Guideline are to the ITAA 1997, unless otherwise specified.

² Section 165-210.

³ Section 165-211 and section 269-105 of Schedule 2F to the *Income Tax Assessment Act 1936* (ITAA 1936).

2. This Guideline provides guidance on what carrying on a similar business⁴ means.

Date of effect

3. The proposed amendments apply to:
- a tax loss for an income year
 - taxable income⁵ for an income year
 - unrealised losses in relation to CGT assets for an income year
 - a net capital loss for an income year, or
 - a debt, incurred in an income year, that the company writes off as bad where the income year starts on or after 1 July 2015.

The similar business test

4. The similar business test operates in a way that is comparable to the same business test,⁶ but removes the negative limbs which apply as part of that test.⁷ These negative limbs can inhibit innovation and business development by denying access to losses merely because transactions or activities are new and of a different kind to those entered into or carried on before a change in ownership or control. Removal of the negative limbs will allow companies to engage in new business activities and transactions that evolve from their business, without losing access to their unutilised losses, encouraging innovation and growth.

5. It is still the case, however, that the overall business of a company must satisfy the similar business test to access losses. In this context, 'similar' does not mean similar 'kind' or 'type' of business. The focus remains on the identity of a business, as well as continuity of business activities and use of assets to generate assessable income.⁸ Accordingly, it will be more difficult to satisfy the similar business test if substantial new business activities and transactions do not evolve from, and complement, the business carried on before the test time. In contrast, where a company develops a new product or function from the business activities already carried on, and this development opens up a new business opportunity or allows the company to fill an existing gap in the market, the business as a whole is likely to satisfy the similar business test.

6. The four factors that must be taken into account, in determining whether a business remains sufficiently similar, require a comparison between the essential characteristics of the business before and after the relevant change in ownership or control.⁹ These four factors do not limit consideration of any other matter that may be relevant to this determination and all factors are weighed up against each other to establish whether the business satisfies the similar business test.

⁴ Subsection 165-211(1).

⁵ Under Subdivision 165-B.

⁶ Paragraph 1.20 of the Explanatory Memorandum to the *Treasury Laws Amendment (2017 Enterprise Incentives No. 1) Bill 2017* (the 'EM').

⁷ Paragraphs 165-210(2)(a) and (b).

⁸ Paragraphs 1.20 and 1.21 of the EM.

⁹ The testing is undertaken throughout the 'business continuity test period' compared with at the 'test time', just as it is for the same business test.

7. The first factor considers the extent to which the assets used to generate assessable income throughout the business continuity test period were the assets used in the business carried on at the test time.¹⁰ Where the assets of the business are being used to the same extent as at the test time to generate assessable income, albeit that they may be producing a different result or effect due to innovative changes, this factor would indicate that the business remains similar to that previously carried on. The continuing use of certain business assets to generate assessable income rather than others may be more relevant to the question of whether the similar business test is passed. For example, assets closely linked to the identity of a particular business, such as goodwill, will be more relevant than other assets such as generic office premises, equipment, and stationery.

8. The second factor compares the extent to which the current activities and operations from which assessable income is generated were also those from which assessable income was generated previously.¹¹ Where the business operator maintains the income generating activities and operations that were previously being undertaken, despite doing them in a different or more efficient way due to innovative improvements, this factor would indicate that the business remains similar to that previously carried on.

9. The third factor compares the current identity of the business with that of the business carried on before the test time.¹² Where new activities have not resulted in the identity of the business changing, then this factor would indicate that the business remains relevantly similar to that previously carried on.

10. The fourth factor requires an assessment of the extent to which the changes to the business resulted from the development or commercialisation of assets, products, processes, services or marketing or organisational methods of the business.¹³ As these amendments are designed to encourage businesses to innovate, such changes will not, in themselves, cause a business to be considered dissimilar. Where changes to the business do not result from such innovation or development, the business is less likely to satisfy the similar business test.

11. The first three factors are concerned with the aspects of the business that have continued, while the fourth factor assesses the nature of any changes that have happened. Where those changes are due to an innovative evolution or development of the business, the business is more likely to be similar to that previously carried on.

Example 1 – Company makes innovative changes to fill gap in the market

12. *ToUrDoor Pty Ltd is an established courier company based in the Sydney CBD. The company operates from an office located in the Sydney CBD, under the brand name 'ToUrDoor', and has established a significant customer base, consisting primarily of office businesses across the Sydney CBD. ToUrDoor Pty Ltd completes short run deliveries of small parcels, letters and paperwork using its fleet of bicycles, and prides itself on being reliable, fast and affordable. Customers can request a courier service through the ToUrDoor website or app, or by calling their direct line. The bicycles are fitted with GPS tracking, allowing customers to track their delivery in real time, and weatherproof, hard-case boxes at the rear in which customers' items are transported. Although the business has been moderately successful, more recently it has been less profitable and incurred tax losses.*

13. *In an attempt to increase the efficiency of its couriers, the company invests in reviewing its fleet of bicycles, including researching potential new bike designs and the use of lightweight materials. To acquire new funds in order to fund this research, ToUrDoor Pty Ltd gained a new equity investor, causing it to fail the continuity of ownership test.*

¹⁰ Paragraph 165-211(2)(a).

¹¹ Paragraph 165-211(2)(b).

¹² Paragraph 165-211(2)(c).

¹³ Paragraph 165-211(2)(d).

14. *The company develops a new bicycle design that incorporates polystyrene, a cost-effective and readily available material, which keeps the contents of the box insulated. Whereas previously the box was a separate compartment attached to the rear of the bicycle, it is now built into the side of the bicycle. ToUrDoor Pty Ltd applies for a patent for the design. Overall, the improved design results in cost savings for the company, because the lightweight material reduces the time taken to complete the deliveries.*

15. *Now that the boxes are insulated and the overall design of the bicycles is sturdier, ToUrDoor Pty Ltd sees an opportunity to deliver food using the new bicycle design. Further changes are made to the design, including the addition of unique fold-out compartments which can be used to store food and beverages. This new design opened up a new client base as restaurants and café owners can now make a booking with ToUrDoor, through the existing booking platforms, to have their food delivered to customers. ToUrDoor Pty Ltd charges the restaurant and café owners a comparable fee in the same way it charges for its document and parcel courier service.*

16. *ToUrDoor Pty Ltd is likely to satisfy the similar business test because:*

- although the company now uses the new patented bicycle design to provide courier and food delivery services (factor one), this change is solely a result of the research and development that went into developing the new bicycle design (factor four)*
- the company's tangible and non-tangible assets, including its physical office, employees, trade mark, website and app continue to be used to the same extent (factor one) to generate assessable income as they previously were*
- the goodwill associated with the company's courier business continues to be used to the same degree (factor one). Meanwhile, the company has established new goodwill and a new customer base, being restaurant and café owners as a result of developing the new bicycle design (factor four)*
- the booking systems on the website and app, as well as the process for placing phone bookings (factor three), have all undergone modifications to accommodate for the additional food delivery service. These modifications resulted from the development of the new bicycle, which allowed the company to diversify its service (factor four)*
- the core business activity of delivering documents and parcels continues to generate assessable income to the same extent, albeit it has evolved to include the delivery of food (factor two), and*
- the company's reputation for providing reliable, fast and affordable courier services has evolved over time, so that their identity is now one of a delivery business that offers a wider range of services (factor three). This shift was a result of the company re-designing its bicycles, modifying the booking process, offering additional services and broadening its marketing audience, all of which resulted from the company engaging in innovation and development (factor four).*

Example 2 – Company engages in no innovation or development to fill market gap

17. *This example is based on the facts at paragraph 12.*

18. *The company notices that there is a growing demand for food delivery, particularly from the office workers that they currently provide courier services to. Following a change in its ownership, ToUrDoor Pty Ltd purchases heat-insulated boxes that can be carried by the courier like a backpack. This enables the company to provide food delivery. Food delivery bookings can be placed without booking courier services. ToUrDoor Pty Ltd buys the food directly from the restaurant and charges the officer workers a delivery fee on top of the cost of the food. The food delivery service proves to be profitable and generates a large portion of the company's assessable income.*

19. *ToUrDoor Pty Ltd is not likely to satisfy the similar business test for the following reasons:*

- *while the company continues to generate assessable income from using the assets it previously used (factor one), the new income generated from food delivery using the new heat-insulated boxes constitutes a significant change. This change did not result from the development or commercialisation of the old bicycle design. Instead, ToUrDoor Pty Ltd simply purchased the heat-insulated box from a third party and used this product to fill an existing gap in the market (factor four), and*
- *there is a change in identity of the business, from a courier business to a broader delivery business with a focus on food (factor three), that did not stem from ToUrDoor Pty Ltd's development of assets, processes or services (factor four). The business might be of a similar type to that carried on previously (delivery service) but it is not sufficiently similar for the purposes of the test.*

Example 3 – Physical clothing retailer shop moves to an online platform

20. *Glad Rags Pty Ltd is a clothing retailer which carries its own line of casual wear under the brand name 'Rags'. The company has established a reputation for offering trendy designs and using quality fabrics. The clothes are manufactured offshore and sold through the company's physical stores which are located across Melbourne and Sydney. Goods are stored in warehouses in both cities, before they are transported to the physical stores when stock needs to be replenished. The business is run from the head office in Sydney.*

21. *Glad Rags Pty Ltd is acquired by a large retail group, causing it to fail the continuity of ownership test. Over a period of five years, the company transitions to a purely online clothing retailer in response to changing shopping trends and the rise in technology. The company makes a number of changes to increase its online sales, including:*

- *engaging a website designer to create a fully-responsive website that is compatible with mobile phones and tablets. The new website is designed to enhance the customer's online shopping experience*
- *renting larger warehouses in Melbourne and Sydney to store the clothing goods*
- *allowing customers to choose between home delivery, or collecting their order from various parcel pick-up locations. Glad Rags Pty Ltd despatches the orders straight from the warehouse to its customers or a parcel pick-up location*
- *hiring a marketing agency to manage its multiple social media platforms. Social media posts and advertisements are strategically timed to maximise exposure and customer engagement, and*

- *using web analytics to create targeted ads on social media platforms and generate personalised newsletters based on the customer's browsing history.*

22. *GladRags Pty Ltd is likely to satisfy the similar business test because:*

- *the company's tangible and non-tangible assets, including its head office, employees, and trade mark, are used to the same degree in its online clothing business to generate assessable income (factor one)*
- *the goodwill generated from its brand name, 'Rags' is retained in the online clothing business. GladRags Pty Ltd has also generated new goodwill from the commencement of the online store, but this has been created from the development of the online platform and the commercialisation of that platform through the use of web analytics (factor four)*
- *the company's core business activity, being the sale of its own brand of clothing, continues to generate assessable income to the same degree in GladRags Pty Ltd's online clothing business (factor two)*
- *although the company has changed its sales channel from multiple physical stores to an online platform (factor two), this is merely a new, and more efficient, way of undertaking the same income generating activities which resulted from the development and commercialisation of the online platform (factor four)*
- *the change in warehouses to accommodate more stock was a consequence of the company's evolution to the online space (factors one and four), and*
- *while the company no longer interacts with its customers face-to-face, it continues to interact with customers as part of its business activities albeit in an online environment (factor two). These online interactions include live-chat assistance with sizing, order confirmation emails, shipping notification emails and tracking facility and newsletters, which resulted from the development and commercialisation of its online platform (factor four).*

Example 4 – Fast food restaurant operates under a new brand name

23. *Mad Cow Ltd owns and operates a fast food restaurant under the name 'MuBurger' on the Gold Coast. The restaurant sells a range of burger varieties, fries, soft drinks and milkshakes. The 'MuBurger' logo contains a cartoon cow, and the restaurant layout is fitted out with distinctive black and white furnishings. The company had once operated a small chain of 'MuBurger' fast food restaurants, all with the same logo, branding, layout, and product mix. However, the company has suffered from a downturn in profitability due to increased competition and only the Gold Coast restaurant remains operating. The company has made substantial tax losses.*

24. *The majority shareholder of Mad Cow Ltd sells his shares to an unrelated party, causing failure of the continuity of ownership test. Mad Cow Ltd then decides to rebrand the business. As part of the rebranding process, it:*

- *hires a new manager to oversee the business*
- *hires a marketing agency to manage its online platforms in order to build its online presence and interact with its customer base*
- *changes its brand name to 'Tully's Steakhouse' and engages a graphics designer to design a new, catchy logo, and*
- *retains the business premises, but transforms the layout of the restaurant to make it contemporary and modern, with the help of an interior designer.*

25. Under the new brand name ‘Tully’s Steakhouse’, the menu has a focus on full, hearty meals and the company markets itself as a family restaurant providing high quality steaks, ribs, and gourmet burgers sourced from prime Queensland beef.

26. Mad Cow Ltd is not likely to satisfy the similar business test because:

- the company no longer generates assessable income from the brand name ‘MuBurger’, which was previously a key asset of the business (factor one). The change from ‘MuBurger’ to ‘Tully’s Steakhouse’ does not result from innovation or development; rather, it is an attempt to present itself to the public as a new and different business. The goodwill associated with the new brand name is unique to Mad Cow Ltd’s new business (factor four)
- although the company retained a number of its original suppliers and its food preparation processes (factor two), the complete transformation of the business identity, through its change to the restaurant layout, branding and logo (factor three), does not result from the company developing or commercialising any part of the business carried on previously (factor four), and
- the new marketing strategy adopted in the company’s current business, devised with the help of the marketing agency to increase sales (factor two), is unique to the new business and also did not result from any innovation undertaken by the company (factor four).

Example 5 – Gold mining business to mixed mining business

27. Mammon Ltd is a gold mining company that operates a site in New South Wales. The company had previously carried out exploration activities which revealed that the gold ore also contained traces of copper. Mammon Ltd applied for, and was granted, a mining tenement, which permits the company to extract, process and refine gold and copper from the ore.

28. As part of the process for extracting gold, the copper in the ore is either wasted or it can be recovered provided that further systems are installed. As copper prices were low and there was little demand for the product, the company did not consider it commercially viable to install the necessary systems to process copper concentrate. As such, Mammon Ltd’s business activity involves producing the gold and selling the product to customers worldwide.

29. Mammon Ltd incurs large losses due to a recent drop in gold prices and the majority shareholder sells his shares to an unrelated party, causing failure of the continuity of ownership test. After this change in ownership, there is a sharp increase in copper prices and Mammon Ltd decides to start processing copper concentrate from the extracted gold ore for sale. The company invests in new equipment to process the copper concentrate from the ore, as well as hiring trained staff.

30. The company commences selling the copper, although the assessable income generated from the sale of copper is insignificant compared to the revenue Mammon Ltd derives from selling gold. Mammon Ltd would satisfy the similar business test because:

- the mining lease, which is a key asset of the company, is used to the same degree in Mammon Ltd’s business as it permits the mining of gold and copper (factor one)
- while the company has acquired new plant and equipment to enable the extraction of copper, the income generated from these assets is comparatively insignificant to the income generated from its gold mining assets, such that there is very little change in the extent to which the company previously used its assets compared with currently (factor one)

- *similarly, the company continues to generate its assessable income primarily from its core business activities and operations of gold mining. Due to the copper mining activities and operations generating comparatively insignificant assessable income, there is very little change to the activities and operations which generate assessable income (factor two)*
- *the acquisition of new plant and equipment to facilitate the extraction of copper concentrate during the processing stage (factor one) is a result of Mammon Ltd evolving. The recovery of the copper as part of its gold mining business has always been envisaged as a possibility during the exploration stage and at the time Mammon Ltd applied for a mining tenement, and*
- *as the copper production is relatively insignificant to its gold production activities, the overall identity of the business remains sufficiently similar (factor three).*

31. *This Example illustrates, in particular, the effect of removing the negative limbs of the same business test. Although the activity of processing and selling copper has not previously been carried on by Mammon Ltd, this new business activity will not alone cause failure of the business continuity test if the company otherwise satisfies the similar business test.*

Commissioner of Taxation

21 July 2017

Your comments

32. You are invited to comment on this Guideline including the proposed date of effect. Please forward your comments to the contact officer by the due date.

Due date: **21 August 2017**

References

ATOlaw topic(s)	Income tax ~~ Tax losses ~~ Other
Legislative references	ITAA 1936 ITAA 1936 Sch 2F 269-105 ITAA 1997 ITAA 1997 165-210 ITAA 1997 165-210(2)(a) ITAA 1997 165-210(2)(b) ITAA 1997 165-211 ITAA 1997 165-211(1) ITAA 1997 165-211(2)(a) ITAA 1997 165-211(2)(b) ITAA 1997 165-211(2)(c) ITAA 1997 165-211(2)(d) ITAA 1997 Subdiv 165-B ITAA 1997 Subdiv 165-E
Related Rulings/Determinations	TR 1999/9
Other references	Explanatory Memorandum to the Treasury Laws Amendment (2017 Enterprise Incentives No. 1) Bill 2017
ATO references	1-B0HE455
BSL	TCN

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