


TR 2006/D4 - Income tax: application of the same business tests to consolidated and MEC groups - principally, the interaction between section 165-210 and section 701-1 of the Income Tax Assessment Act 1997

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Draft Taxation Ruling

Income tax: application of the same business tests to consolidated and MEC groups – principally, the interaction between section 165-210 and section 701-1 of the *Income Tax Assessment Act 1997*

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What this Ruling is about

1. This Ruling sets out the Commissioner's views on how the same business test applies in the context of determining whether deductions are available to the head company of a consolidated group in respect of:

- prior year tax losses;
- bad debts; or
- net capital losses.

2. This Ruling also sets out the Commissioner's views on the application of the same business test to head companies that are required to determine whether they calculate their taxable income and tax loss, or net capital gain and net capital loss, for an income year under Subdivision 165-B, Subdivision 165-CB or Subdivision 165-CC of the *Income Tax Assessment Act 1997* (ITAA 1997).

3. Unless otherwise specified:

- all legislative references in this Ruling relate to the ITAA 1997; and
- all references to tax losses include a reference to tax losses, net capital losses or bad debts.

Key consolidation concepts

4. Subsection 701-1(1) provides that, for the head company core purposes, an entity which is a subsidiary member of a consolidated group, and any other subsidiary member of the group, are taken to be parts of the head company. This is the 'single entity rule'.

5. Subsection 701-1(2) sets out the head company core purposes to which subsection 701-1(1) refers. In terms of subsection 701-1(2), the head company core purposes are working out the amount of the head company's liability (if any) for income tax calculated by reference to any income year, and working out the amount of the head company's loss (if any) for any such income year.

6. Taxation Ruling TR 2004/11: Income tax: consolidation: the meaning and application of the single entity rule in Part 3-90 of the *Income Tax Assessment Act 1997* explains the meaning and application of the 'single entity rule'.

7. Section 701-5 provides that, for the head company core purposes in relation to the period after an entity becomes a subsidiary member of the group, everything that happened in relation to the entity before it became a subsidiary member is taken to have happened in relation to the head company. This is the 'entry history rule'. However, section 165-212E provides:

For the purposes of the *same business test, if an entity (the **joining entity**) becomes a *subsidiary member of a *consolidated group or a *MEC group, section 701-5 (the entry history rule) does not operate to take the *business of the *head company of the group to include the business of the joining entity before it become a *member of the group.

Section 165-212E applies from on or after 1 July 2002.

Class of entities/Scheme

8. This Ruling applies to:

- (a) the head company of a consolidated group or a MEC (multiple entry consolidated) group that is seeking a deduction for a prior year tax loss or the application of a net capital loss, or deduction for a bad debt in a year of income in which the head company is unable to demonstrate that the requirements of the continuity of ownership test in section 165-12 or section 165-123 (as appropriate) are satisfied;

- (b) the head company of a consolidated group or a MEC group that is required to calculate its taxable income or tax loss under Subdivision 165-B, or net capital gain or net capital loss under Subdivision 165-CB;
- (c) the head company of a consolidated group or a MEC group that has an unrealised net loss at the time of a change of ownership or control and must determine, in accordance with Subdivision 165-CC, whether that unrealised net loss will restrict the extent to which a future capital loss or revenue loss can be taken into account; and
- (d) the head company of a consolidated group or a MEC group that has accumulated tax losses or net capital losses at the time that it is acquired by another consolidated group and is seeking to determine the extent to which those losses can be transferred to the head company of the new consolidated group (Subdivision 707-A).

Definitions

9. In this Ruling the terms '**same business test**', '**new business test**' and '**new transactions test**' have the meanings adopted in Taxation Ruling TR 1999/9: Income tax: the operation of sections 165-13 and 165-210, paragraph 165-35(b), section 165-126 and section 165-132. The relevant paragraphs of TR 1999/9 are set out below.

12. The requirement in section 165-13 and subsection 165-210(1) (or the equivalent provision in the 50D test, the 63C test and the 80F test [in the *Income Tax Assessment Act 1936*]) is referred to in this Ruling as the 'same business test'. For the purpose of the same business test, a company is treated as carrying on one overall business at the change-over and during the period of recoupment since the reference to 'business' in the same business test is a reference to all of the activities carried on by the company at the change-over and during the period of recoupment, irrespective of whether those activities constitute or are treated by the company as constituting separate or distinct activities, enterprises, divisions or undertakings carried on by the company...

14. The requirement in subsections 165-13 and 165-210(2) (or the equivalent provisions in the 50D test (which includes subsection 165-210(4)), the 63C test and the 80F test) relating to 'business of a kind' is referred to in this Ruling as the 'new business test'. In the new business test there is a reference to 'business of a kind' that the company did not carry on before the change-over. In the new business test the word 'business' has a different meaning from the word 'business' in the same business test; it refers to each kind of enterprise or undertaking comprised in the overall business carried on by the company at the change-over and during the period of

recoupment. The new business test puts a limit on the type of expansion the company may undertake if it is to retain the benefit of accumulated losses; for the taxpayer may not engage in an undertaking or enterprise of a kind in which it did not engage before the change-over and still benefit from accumulated losses.

15. The requirement in section 165-13 and subsection 165-210(2) (or the equivalent provisions in the 50D test (which includes subsection 165-210(4)), the 63C test and the 80F test) relating to a 'transaction of a kind' not entered into in the course of the taxpayer's business operations is referred to in this Ruling as the 'new transactions test'. The new transactions test is directed to preventing the injection of income into a loss company that has satisfied the same business test and the new business test. The new transactions test includes all transactions entered into in the course of the company's business operations and not merely those that are 'isolated' or 'independent'. However, generally speaking, the new transactions test is not failed by transactions of a type that are usually unmotivated by tax avoidance, namely, transactions that could have been entered into ordinarily and naturally in the course of the business operations carried on by the company before the change-over. Conversely, a transaction entered into during the period of recoupment and which is outside the course of the business operations before the change-over, or which is extraordinary or unnatural when judged by the course of the business operations before the change-over, is usually a transaction of a different kind from the transactions actually entered into by the company before the change-over.¹

10. Both '**test time**' and '**same business test period**' are defined in various provisions of the ITAA 1997, and for the purpose of this Ruling those phrases take the meanings:

- (a) specified in section 165-13 when considering deductions for prior year tax losses, the application of prior year net capital losses and the determination of whether or not unrealised net losses will limit the extent to which capital or revenue losses can be taken into account;
- (b) specified in section 165-35 when working out the taxable income or tax loss, or the net capital gain or net capital loss, for an income year during which the head company has not maintained the same ownership and control;
- (c) specified in section 165-126 when considering deductions for bad debts; and
- (d) specified in section 707-125 or section 707-135 when considering the extent to which previously unutilised losses can be transferred to the head company of a consolidated group that has acquired the head company of another group with unutilised losses.

¹ See also paragraphs 30 to 90 of TR 1999/9 for a discussion of these terms.

11. A reference in this Ruling to a consolidated group should be read as including a multiple entry consolidated (MEC) group.

Ruling

The same business test and the single entity rule

12. If in respect of a particular year of income the head company of a consolidated group has failed a relevant continuity of ownership test, then the same business test in section 165-210 will be relevant when calculating the taxable income of the head company (refer to the single entity rule, section 701-1 and the discussion set out in paragraphs 3, 4, 7, 8 and 17-24 of TR 2004/11).

13. In order to satisfy subsection 165-210(1) the head company of a consolidated group needs to show that the one overall business carried on by that head company throughout the same business test period was the same one overall business as carried on by the head company immediately before the appropriate test time. Under subsection 701-1(1) subsidiary members of a consolidated group are taken, for the purposes of the same business test (among other purposes), to be parts of the head company. Consequently, when determining the one overall business carried on by the head company of a consolidated group for the purposes of subsection 165-210(1) it is necessary to have regard to the activities of the subsidiary members of the group. In this context the principles set out in TR 1999/9 in respect of the application of the same business test to a single company apply equally to the head company of a consolidated group.

14. In this context the one overall business of the head company is to be identified by examining all of the activities, enterprises or undertakings carried on:

- at the appropriate test time by all those entities that were members of the consolidated group at that time; and
- by all entities during that part of the same business test period when they were members of the consolidated group.

15. When applying the new business test and new transactions test to the head company, regard must be had to the enterprises, undertakings and transactions that were carried on or entered into before the test time by entities while they were members of the consolidated group. These activities are then compared with the enterprises, undertakings and transactions carried on or entered into by all entities while they are members of the consolidated group during the same business test period. This comparison determines whether the enterprises, undertakings and transactions before the test time and during the same business test period are different in kind.

16. It is not necessary that a business carried on during the same business test period by an entity in the group be of a kind carried on by that **same** entity before the test time, provided an entity within the group carried on that activity during the period before the test time when that entity was a member of the consolidated group.

Section 165-212E and the entry history rule

17. Working together, section 165-212E and the entry history rule within section 701-5 operates in such a way that the activities which comprise a business carried on by an entity during any period when that entity was not a member of a consolidated group are ignored when determining either the 'business' of the head company of a consolidated group, or whether the 'new business test' or the 'new transactions test' have been satisfied.

18. The examples set out in paragraphs 19 to 52 of this Ruling, specifically deal with the application of the same business test to the head company of a consolidated group. Additionally, the examples discussed in paragraphs 96 to 184 of TR 1999/9, which illustrate the application of the same business test to a single company, are of assistance in determining the one overall business of the head company of a consolidated group.

Examples

Facts

19. **Hold Co** is the head company of a consolidated group. It holds shares in other companies but otherwise does not conduct any business activity. Hold Co has a 30 June tax year.

20. **Property Co 1, Property Co 2, and Property Co 3** are all 100% subsidiaries of Hold Co. Each is a parent of a number of property development companies. The Property Co 1 sub-group is involved in the construction and sale of residential apartments. The Property Co 2 sub-group is involved in commercial and industrial property development. The Property Co 3 sub-group is engaged in the construction and management of shopping centres. Traditionally, property development has been the core business of the group and success in this industry has facilitated new business acquisitions by the group and expansion into other industries.

21. The Hold Co group acquired, prior to 1 July 2002, **Retail Co** and its subsidiaries, a large but ailing national department store chain, which had a presence in many of the shopping centres managed by the Property Co 3 sub-group. Over time, the profitability of the department store chain was restored and began to contribute significantly to the overall profits of the Hold Co group.

22. The Hold Co group also acquired, prior to 1 July 2002, **Mag Co 1**, **Mag Co 2**, and **Mag Co 3** which were engaged in the business of magazine publishing. Apart from a general desire to move into the print media business, Hold Co also saw natural synergies in terms of advertising its retail business. Mag Co 1 and Mag Co 2 are responsible for the production of two popular culture magazines released weekly and monthly respectively, which have an extremely wide national circulation. Mag Co 3 produces a quarterly fishing magazine which has a very limited circulation. The scale of the business operations of Mag Co 3 is negligible by comparison to Mag Co 1 and Mag Co 2.

23. After a massive downturn in the property and retail sectors, the Hold Co consolidated group incurred large tax losses during the years ended 30 June 2003 and 2004. On 31 March 2004, there was a change in majority ownership of Hold Co.

24. The group comprising Hold Co and all of its wholly owned subsidiaries was consolidated on 1 July 2002.

25. This factual matrix is the starting point for all of the examples set out in paragraph's 26 to 52 of this Ruling. Note that the examples in this Ruling proceed on the assumption that section 165-212A does not apply. That section provides a total income ceiling for a company applying the same business test in an income year.

Example 1

26. Hold Co has to apply Subdivision 165-B to work out the taxable income and loss for the income year ended 30 June 2004. To do so it needs to apply the same business test (section 165-35). For the application of that test, the test time is 31 March 2004 and the same business test period is the period from the change of ownership to 30 June 2004.

27. The activities being carried on by entities within the group prior to 31 March 2004 and during the period from 31 March to 30 June 2004 have to be examined in accordance with the principles set out in paragraphs 59 to 62 of TR 1999/9 to establish if the same business test in subsection 165-210(1) is satisfied. In essence this involves a comparison of the business of the relevant taxpayer immediately before the test time with the business of the taxpayer during the same business test period. As a consequence of the operation of the single entity rule in section 701-1, the business of Hold Co as the head company of the consolidated group would be characterised as a one overall business that incorporates the various elements of property development, retail activity and magazine publishing conducted within the group.

28. If the same business test is satisfied, it would then be necessary to examine whether any entities in the group had engaged in new activities or enterprises during the same business test period to establish whether or not they are of a similar kind to activities or enterprises undertaken within the group before the change of ownership occurred.

29. The transactions undertaken by all entities in the group during the same business test period would also have to be examined to determine whether or not any assessable income has been derived within the group from transactions of a kind not undertaken within the group before 31 March 2004.

30. If the same business test of subsection 165-210(1) is satisfied and the examination of the activities, enterprises and transactions undertaken by entities when they were members of the consolidated group during the same business test period reveals that no assessable income has been derived during that period from a business or transaction of a kind not previously undertaken, Hold Co will be considered to have passed the same business test and will not be required to calculate its taxable income and tax loss for the year ended 30 June 2004 under Subdivision 165-B.

Example 2

31. During the year ended 30 June 2005, Hold Co transfers all of the business activities of Mag Co 1 to Mag Co 2 and disposes of all of its shares in Mag Co 1 which previously produced culture magazines.

32. In that year, Hold Co seeks a deduction for losses incurred in the year ended 30 June 2003 and, because of the change of ownership on 31 March 2004, relies on the same business test being satisfied.

33. The question for consideration in this case is whether or not the disposal of the shares in Mag Co 1 will cause failure of the same business test as outlined in subsection 165-210(1).

34. The same business test involves comparison of the business of the relevant taxpayer immediately before the test time with the business of the taxpayer during the same business test period. In this example the test time is 31 March 2004, and the same business test period is the year ended 30 June 2005. The business of Hold Co as the head company of the consolidated group would be characterised as a one overall business that incorporates the various elements of property development, retail activity, and magazine publishing conducted within the group.

35. The disposal of the shares in Mag Co 1 has not changed the business being carried on by Hold Co as the head company of the consolidated group. The activities conducted by Mag Co 1 before the test time are still being conducted within the group during the same business test period and will be taken into account in the identification of the business of Hold Co at each of those times.

36. However, if the disposal of the shares in Mag Co 1 produces assessable income (for example a net capital gain), as unlikely as that may be on the facts presented, and the disposal is a transaction of a kind not previously entered into within the group, then the disposal of the shares in Mag Co 1 will cause the same business test in section 165-210 to be failed. A different result would occur if the disposal did not result in assessable income (refer to paragraphs 86 and 87 of TR 1999/9).

Example 3

37. During the year ended 30 June 2005, Hold Co disposes of all of its shares in Mag Co 3 and the group ceases to have any involvement in the production of the fishing magazine.

38. In the year ended 30 June 2005, Hold Co seeks a deduction for losses incurred during the year ended 30 June 2003 and, because of the change of ownership on 31 March 2004, relies on the same business test being satisfied.

39. The immediate question for consideration in this example is whether or not the disposal of the business of Mag Co 3 causes failure of the same business test. As stated in paragraph 13 of TR 1999/9, the analysis of whether the same business continues after a change of ownership may give rise to questions of degree and ultimately depends on the facts of the case. In making the analysis, it needs to be acknowledged that a company may expand or contract its activities without necessarily ceasing to carry on the same business.

40. Identifying and defining the one overall business of the relevant taxpayer, that is, Hold Co as the head company of the consolidated group, involves looking at all the things done and the activities carried out:

- immediately before the test time, 31 March 2004, by entities that were members of the group at that time; and
- by entities during the year ended 30 June 2005 (the same business test period) when they were members of the consolidated group.

41. The business of Hold Co as the head company of the consolidated group would be characterised as a one overall business that incorporates the various elements of property development, retail activity, and magazine publishing conducted within the group.

42. The facts outlined under the Facts heading at paragraph 23 indicate that the business of Mag Co 3 is negligible in relation to the overall activities of the consolidated group. In these circumstances, the disposal of Mag Co 3 and its related business activities is unlikely, of itself, to cause failure of the same business test.

43. If the disposal of the shares in Mag Co 3 produces assessable income (for example a net capital gain), and the disposal is a transaction of a kind not previously entered into within the group, then the disposal of the shares in Mag Co 3 will cause the same business test in section 165-210 to be failed. A different result would occur if the disposal did not result in assessable income (refer to paragraphs 86 and 87 of TR 1999/9).

Example 4

44. During the year ended 30 June 2005 the existing members of the consolidated group continued to carry on all of the activities they carried on immediately before the change of ownership occurred on 31 March 2004, and there were no significant changes to the nature or scale of each of those activities. In September 2004, Hold Co acquired all of the shares in Boat Co 1 which had conducted a ferry service since before 31 March 2004. Boat Co 1 is a very profitable company and adds significantly to the income of the group for the remainder of the year ended 30 June 2005.

45. In the year ended 30 June 2005, Hold Co seeks a deduction for losses incurred during the year ended 30 June 2003 and, because of the change of ownership on 31 March 2004, relies on the same business test being satisfied. The test time for the purposes of subsection 165-13(2) is 31 March 2004 and the same business test period is the year ended 30 June 2005.

46. The first issue for consideration in this case is the impact, if any, that the acquisition of Boat Co 1 and its associated activities has on the identification of the business of Hold Co as the head company of the consolidated group for the purpose of the same business test.

47. After the acquisition of Boat Co 1, the business of Hold Co as the head company of the consolidated group would be characterised by reference to all of the activities carried on by members of the group during the period in which they were members of the group. This process results in a one overall business incorporating the various elements of property development, retail activity, magazine publishing and ferry service conducted within the group.

48. Due to the application of section 165-212E when characterising the business of Hold Co at 31 March 2004 (the test time) it is necessary to ignore the activities comprising the business conducted by Boat Co prior to becoming a member of the group. Consequently, the business of Hold Co at that time does not include the ferry business. In this case, it is unlikely that Hold Co will satisfy the requirements of the same business test during the year ended 30 June 2005. No deduction would be available for the tax loss incurred during the year ended 30 June 2003.

49. Even if, as a result of the analysis of the activities of the group at the relevant times, it is determined that the business of Hold Co as the head company of the consolidated group has not been sufficiently changed by the introduction of Boat Co 1 to cause failure of subsection 165-210(1), the new business test of paragraph 165-210(2)(a) would be failed and the loss deduction would not be available to Hold Co.

Example 5

50. In July 2004 Hold Co acquires Mag Co 4 which produces a quarterly fishing magazine. Mag Co 4 also runs a fishing boat hire activity which it has operated since 30 April 2004. The boat hire activity contributes some income to the group but does not achieve the level of profitability that was anticipated at the date of acquisition of the company. In May 2005, Mag Co 4 ceases the boat hire activity.

51. Hold Co seeks to claim a deduction in the year ended 30 June 2005 for losses incurred in the year ended 30 June 2003 and, because of the change of ownership on 31 March 2004, relies on the same business test being satisfied.

52. The boat hire activity is a business that produces assessable income for Hold Co during the same business test period but it was not a business of a kind that Hold Co had carried on before the test time. Hold Co will fail the new business test in the year ended 30 June 2005 and will be unable to deduct the 2003 loss.

Date of effect

53. It is proposed that when the final Ruling is issued, it will apply both before and after its date of issue. However, the Ruling/Determination will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling/Determination (see paragraphs 21 and 22 of TR 92/20)

Commissioner of Taxation

29 March 2006

Appendix 1 – Explanation

❶ *This Appendix is provided as information to help you understand how the Commissioner’s preliminary view has been reached. It does not form part of the proposed binding public ruling.*

54. This Ruling adopts the approach that a head company carries on one overall business identified by reference to all the consolidated group activities.

Section 165-212E and the entry history rule

55. Section 165-212E provides that for the purposes of the same business test, if an entity becomes a subsidiary member of a consolidated group, the entry history rule does not operate to take the business of the head company of the group to include the business of the joining entity before it became a member of the group.

The structure of section 165-210

56. As explained in paragraphs 24 to 27 of TR 1999/9, subsections 165-210(1) and (2) include three tests, each of which must be satisfied by a company in order for the company to meet the requirements of section 165-13 and section 165-210 and thereby not be prevented by section 165-10 from deducting prior year losses.

57. Those three tests, referred to in paragraphs 24 to 27 of TR 1999/9 as the ‘**same business test**’, the ‘**new business test**’ and the ‘**new transactions test**’, are applicable to the head company of a consolidated group that is seeking to satisfy section 165-13.² The principles set out in TR 1999/9 about the identity of a business and the issues that are relevant to be considered in identifying a business that is being carried on, are applicable in relation to the head company of a group.

The meaning of ‘the business’ of the head company of a consolidated group

58. The effect of the single entity rule is that the tests contained in section 165-210 will apply to the head company of a consolidated group as if the subsidiary members of the group are parts of the head company. Effectively, the tests will apply as if the group is, in legal form, a single company operating along divisional lines.

² It should be noted that section 165-212A provides that a company does *not* satisfy the same business test for an income year if the ‘total income’ of the company for the income year is more than \$100 million. Section 165-212B provides a definition of total income.

59. Because each subsidiary member is taken to be a part of the head company the business of the head company must be ascertained by reference to the activities carried on by an entity during a relevant period, or at a relevant point in time, provided that the entity was a member of the consolidated group during that relevant period or at that relevant point in time.

60. Paragraphs 28 and 29 of TR 1999/9 sets out the meaning of the word 'business' in relation to a single company and explores the different contexts in which the word is used in section 165-210. TR 1999/9 explains the meanings that the word can have within those different contexts for companies operating as a distinct commercial entity. In seeking to satisfy subsection 165-210(1), the head company of a consolidated group will need to examine each of the activities, enterprises or undertakings being carried out at the appropriate test time by all those entities that were members of the consolidated group at that time; and by all entities during that part of the same business test period when they were members of the consolidated group. The identification of each of those activities, enterprises and undertakings, and the determination of what is relevant to examine in relation to the business of the group that is taken to be carried on by the head company, when applying the tests in section 165-210 should be done in accordance with the principles set out in TR 1999/9.

The new business test

61. In the new business test there is a reference to 'business of a kind' that the company did not carry on before the test time. In the new business test, the word 'business' has a different meaning from the word 'business' in the same business test; it refers to each kind of enterprise or undertaking comprised in the overall business carried on by the consolidated group before the test time and during the same business test period.³ The new business test puts a limit on the type of expansion that the group may undertake if it is to retain the benefit of accumulated losses. In order for the head company to benefit from accumulated losses, it must not derive assessable income from an undertaking or enterprise of a kind that it is not treated as having been engaged in before the test time.

62. If, during the same business test period, any member of the group commences to derive income from an enterprise or undertaking of a kind that was not carried on within the group before the test time, the head company may fail the test.

63. It must however be noted that because of the operation of the single entity rule, satisfaction of the new business test may be achieved if the business carried on during the same business test period by the head company of the group is of a kind carried on by any entity during the period before the test time when that entity was a member of the consolidated group.

³ The method for determining the overall business carried on by the consolidated group is set out in paragraphs 28 and 29 of TR 1999/9.

The new transactions test

64. In the context of consolidation, the new transactions test is directed at preventing the injection of income into a consolidated group, the head company of which has satisfied the same business test and the new business test in relation to available tax losses, net capital losses or bad debts. The new transactions test looks at all transactions entered into in the course of the group's business operations by an entity while a member of the group. It is not merely concerned with those transactions that are 'isolated' or 'independent'. A transaction entered into during the same business test period which is:

- outside the course of the group's business operations, or which is extraordinary; or
- unnatural when judged by the course of the group's business operations before the test time,

will usually be a transaction of a different kind from those transactions actually entered into or carried on before the test time by an entity while a member of the consolidated group.

Appendix 2 – Alternative views

① *This Appendix sets out alternative views and explains why they are not supported by the Commissioner. It does not form part of the proposed binding public ruling.*

65. There are a number of alternative views to those expressed in this Ruling. The Tax Office responses to these alternative views are set out in paragraphs 67 to 70, 79, 80, 83 and 84 of this Ruling.

Only the head company's business is relevant

66. Under one alternative approach the business of the head company is determined by reference only to the activities of that company. Under this approach only the activities actually undertaken by the head company would be considered in seeking to identify the business being carried on at the relevant test time and during the same business test period. The activities being undertaken by other members of the consolidated group would be ignored.

Tax Office response

67. Applying the same business test to the head company without reference to the activities of other entities of the group is not compatible with the stated intention of the consolidation legislation or the objectives sought to be achieved by the same business test provisions.

68. For this approach to be arguable, it is necessary to read the words 'working out the amount of the head company's liability (if any) for income tax' in subsection 701-1(2) very narrowly. Those words would need to be interpreted in such a way that determining the business the head company carried on immediately before the test time, as required by subsection 165-210(1), is not considered to be working out the head company's liability for income tax, that is, it is not considered to be for head company core purposes.

69. TR 2004/11 explains the operation of the single entity rule (SER). Several paragraphs from that Ruling are set out below:

Consequences of the SER

7. For income tax purposes the SER deems subsidiary members to be parts of the head company rather than separate entities during the period that they are members of the consolidated group.
8. As a consequence, the SER has the effect that:
 - (a) the actions and transactions of a subsidiary member are treated as having been undertaken by the head company;

- (b) the assets a subsidiary member of the group owns are taken to be owned by the head company (with the exception of intra-group assets) while the subsidiary remains a member of the consolidated group;
- (c) assets where the rights and obligations are between members of a consolidated group (intra-group assets) are not recognised for income tax purposes during the period they are held within the group whether or not the asset, as a matter of law, was created before or during the period of consolidation (see also paragraph 11 and paragraphs 26-28); and
- (d) dealings that are solely between members of the same consolidated group (intra-group dealings) will not result in ordinary or statutory income or a deduction to the group's head company.

24. This ensures that working out the consolidated group's taxable income and losses and offsets, record keeping requirements and penalties, are addressed on the basis that the group is a single entity with the head company as that entity. Broadly, this provides parity of income tax treatment between a consolidated group, treated as a single entity, and a non-consolidated company.

70. Given this explanation it is not considered appropriate to read subsection 701-1(2) so narrowly that the business of the head company, for the purposes of applying section 165-210, does not take into account the activities of the subsidiary members of the group. The intention of the same business test is to provide a basis for allowing deductions for prior year tax losses to a company which has undergone a change of ownership.⁴ The deduction is available where the objective evidence indicates that the change of ownership is not followed by a change of business, or the introduction of new business activities or income earning transactions, providing a new source of assessable income against which the new owners can offset the accumulated losses. In a consolidated group the head company is the only entity that returns any assessable income and is the only entity entitled to a deduction for tax losses. All of the activities of the consolidated group must be considered when determining both the assessable income and allowable deductions of the head company. Likewise all the activities of the group are relevant when applying the same business test.

Multiple 'businesses' of the head company

71. There is another alternative approach under which the head company is viewed as carrying on a number of businesses for the purposes of subsection 165-210(1). This view stems from a general proposition that it is not appropriate or realistic to identify and define a single overall business of a consolidated group.

⁴ However, the availability of the deduction is subject to other limitations, see section 165-212A.

72. The legislative basis for this view is said to be paragraph 23(b) of the *Acts Interpretation Act 1901* which states (in part) that ‘... unless the contrary intention appears ... words in the singular number include the plural and words in the plural number include the singular’. Therefore the word ‘business’ in sections 165-13, 165-126, 165-132 and 165-210 should be taken to include the plural ‘businesses’. Consequently, when examining the business of the head company of a consolidated group for the purposes of applying the same business test, it is necessary to consider the businesses of all members of that group.

73. One method of characterising the ‘business’ of the head company of the consolidated group under this view is to identify the separate businesses being conducted by the individual members of the consolidated group by reference to the activities being carried on immediately before the test time by each individual entity in the group. All of these separate businesses are then taken to be distinct businesses carried on by the head company. If any of those businesses cease to be carried on before the end of the same business test period, the test in subsection 165-210(1) will not be satisfied.

74. This would require application of the principles set out in TR 1999/9 to each of the entities in the group at the test time to identify the business being carried on by each entity. It would then be necessary to apply those principles to the activities of entities in the group throughout the same business test period to ascertain whether or not those businesses identified at the test time have continued during the relevant period. In this regard, it would not be necessary that the businesses are being carried on by the same entities, or even that the entities that conducted the businesses at the test time continue to be members of the group. It would only be required that the identified businesses continue to be carried on within the consolidated group.

75. It would also be necessary to identify whether or not any entity in the group has commenced to derive assessable income from either of the following:

- A business of a kind that had not previously been undertaken by a member of the consolidated group before the test time.
- A transaction of a kind that had not previously been entered into in the course of the business operations that had been conducted by a member of the consolidated group before the test time.

76. A cessation of the business activities of one entity within the group, even if the activities of that entity are insignificant in terms of the overall profitability of the group, could result in the head company being unable to deduct prior year losses.

77. A second method of characterising the ‘business’ of the head company of the consolidated group under this view is by reference to all the activities being undertaken by members of the consolidated group immediately before the test time and then aggregating some of those activities into discrete businesses. Under this approach if the activities of two or more members of the group are sufficiently integrated, they can be identified as constituting one business. As with the first method, the group may be identified as carrying on a number of businesses but, unlike that approach, the number of those businesses is not determined by the number of entities in the group at the test time.

78. This approach would require detailed analysis of the activities of all entities in the group at the test time and a decision as to which activities are sufficiently integrated to support a conclusion that those activities are part of one business. The businesses identified as being conducted at the test time would be compared with the businesses being carried on throughout the same business test period. If any of those businesses has ceased, the head company would not satisfy the requirements of subsection 165-210(1). If any new business has been commenced, the head company would not satisfy paragraph 165-210(2)(a) unless that new business is of a kind with one of the businesses carried on within the group before the test time.

Tax Office response

79. These two methods depend, for their effectiveness, on there being no contrary intention to ‘business’ in subsection 165-210(1) being read as including ‘businesses’. The Tax Office considers that section 165-210 does express such a contrary intention.

80. Paragraphs 28 and 29 of TR 1999/9 explain the meaning of ‘business’. Subsection 165-210(1) would not achieve the desired outcome in either a consolidated or non-consolidated context if the word ‘business’ is read as ‘businesses’. If business was read as businesses the purchaser of a loss company could retain the benefit of the loss deductions even if activities are commenced that inject substantial income into the company.

Section 165-212E does not ‘turn off’ the entry history rule for the purposes of applying the ‘business of a kind’ or the ‘transactions of a kind’ tests

81. It has been argued that section 165-212E does not actually prevent the operation of the entry history rule because of a mismatch between the wording of that section and the wording of the entry history rule in section 701-5. Section 165-212E is drafted in terms of not taking ‘... the *business of the *head company of the group to include the business of the joining entity before it became a *member of the group’. However, section 701-5 is drafted in terms of ‘... everything that happened in relation to it before it became a subsidiary member ...’. That is the entry history rule is not directly concerned with the business carried on by an entity prior to it becoming a subsidiary member. Consequently, it is argued that a provision that requires the ‘business’ of an entity to be disregarded does not also require that the actual underlying activities of the entity be disregarded.

82. Alternatively it has been argued that section 165-212E does not ‘turn off’ the entry history rule for the purposes of applying the ‘the business of a kind’ or the ‘transactions of a kind’ tests, as the section only refers to the ‘same business test’ rather than to all three relevant tests in section 165-210(1)-(3).

Tax Office response

83. Neither of these two alternative arguments is compatible with the stated purpose of section 165-212E and the clear statement as to its intended operation, and would result in anomalous outcomes. The Explanatory Memorandum to the Tax Laws Amendment (Loss Recoupment Rules and Other Measures) Bill 2005 clearly sets out the intended operation of the provision.

3.17 This Bill clarifies that the entry history rule does not operate to deem the head company of a consolidated or MEC group to carry on the activities of a subsidiary member of the group during a period before the subsidiary member joined the group. ...

3.18 When an entity joins a consolidated or MEC group, its activities are treated as activities of the head company from its joining time for the purposes of the SBT. Activities that the entity carried on before the joining time are not attributed to the head company for the purposes of determining whether the head company carried on the same business.

84. When read in context a combination of the section 165-212E and the entry history rule within section 701-5 operate in such a way that the activities which comprise a business carried on by an entity during any period when that entity was not a member of a consolidated group are ignored when determining either the ‘business’ of the head company of a consolidated group, or whether the ‘new business test’ or the ‘new transactions test’ have been satisfied.

Appendix 3 – Your comments

85. We invite you to comment on this draft Taxation Ruling. Please forward your comments to the contact officer by the due date. (Note: The Tax Office prepares a compendium of comments for the consideration of the relevant Rulings Panel. The Tax Office may use a sanitised version (names and identifying information removed) of the compendium in providing its responses to persons providing comments. Please advise if you do not want your comments included in a sanitised compendium.)

Due date: 12 May 2006

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Appendix 4 – Detailed contents list

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 1999/9; TR 2004/11

Subject references:

- consolidated group
 - consolidation – multiple entry consolidated group
 - consolidation – same business test
 - entry history rule
 - head company
 - head company of a MEC group
 - losses
 - MEC
 - MEC losses
 - new business test
 - new transactions test
 - same business test
 - single entity rule
- ITAA 1997 165-35(b)
 - ITAA 1997 Subdiv 165-CB
 - ITAA 1997 Subdiv 165-CC
 - ITAA 1997 165-123
 - ITAA 1997 165-126
 - ITAA 1997 165-132
 - ITAA 1997 165-210
 - ITAA 1997 165-210(1)
 - ITAA 1997 165-210(2)
 - ITAA 1997 165-210(2)(a)
 - ITAA 1997 165-210(3)
 - ITAA 1997 165-210(4)
 - ITAA 1997 165-212A
 - ITAA 1997 165-212B
 - ITAA 1997 165-212E
 - ITAA 1997 701-1
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 - ITAA 1997 701-1(2)
 - ITAA 1997 701-5
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 - ITAA 1997 707-125
 - ITAA 1997 707-135
 - AIA 1901 23(b)

Legislative references:

- ITAA 1997 165-10
- ITAA 1997 165-12
- ITAA 1997 165-13
- ITAA 1997 165-13(2)
- ITAA 1997 Subdiv 165-B
- ITAA 1997 165-35

Other references:

- Explanatory Memorandum to the Tax Laws Amendment (Loss Recoupment Rules and Other Measures) Bill 2005

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Income Tax ~~ Consolidation ~~ single entity rule