TR 94/D42 - Income tax: the operation of section 80E, section 50D, section 63C and section 80F

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Draft Taxation Ruling
Income tax: the operation of section 80E, section 50D, section 63C and section 80F

other Rulings on this topic

Draft Taxation Rulings (DTRs) represent the preliminary, though considered, views of the Australian Taxation Office.

DTRs may not be relied on by taxation officers, taxpayers and practitioners. It is only final Taxation Rulings which represent authoritative statements by the Australian Taxation Office of its stance on the particular matters covered in the Ruling.Draft Taxation Rulings (DTRs) represent the preliminary, though considered, views of the Australian Taxation Office.

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What this Ruling is about

1. This Ruling is about the tests based on continuity of business which permit losses incurred by a company to be deductible despite events such as a change in ownership of the company's shares. The Ruling describes the operation of section 80E, section 50D, section 63C and section 80F of the *Income Tax Assessment Act 1936* (ITAA).

General outline of the operation of section 80E

2. Where a company does not satisfy the requirements concerning its continuing ownership and control as described in section 80A and section 80B, the general rule is that a company cannot claim a deduction for losses incurred prior to the relevant change in ownership or control. The only exception to this general rule is where the company satisfies certain tests pertaining to the continuity of business.

3. Where a company does not satisfy the requirements concerning the occurrence of certain events or circumstances as described in section 80DA, the general rule is that a company cannot claim a deduction for prior year losses incurred prior to the occurrence of the relevant event or circumstance. The only exception to this general rule is where the company satisfies certain tests pertaining to the continuity of business of the company.

4. The tests relating to the continuity of business are set out in section 80E. Where the requirements of section 80E ('**80E test**') are satisfied, the company will not be prevented under section 80A or section 80DA from claiming a deduction for a prior year loss.

5. The conditions for complying with section 80E are set out in paragraphs 9 to 13 of this Ruling. However, broadly speaking, the 80E test will be satisfied where a company, at all times during the year in which it claims a deduction for a prior year loss:

- carried on the same business it carried on immediately before it ceased to satisfy the continuing ownership and control requirements described in section 80A;
- did not carry on any business other than that same business;
- only derived, in the case of transactions, income from transactions of a kind that it had entered into in the course of that same business; and
- the anti-avoidance provisions in subsection 80E(2) do not apply to the company.

Similar provisions in section 50D, section 63C and section 80F

6. Tests relating to the continuity of business which are similar to the 80E test are also set out in:

- subsections 50D(4) to (9) ('**50D test**');
- section 63C ('**63C test**'); and
- section 80F ('**80F test**').

7. Statements made in this Ruling on the application of the 80E test also represent statements on the application of the 50D test, the 63C test or the 80F test to the extent that the 50D test, the 63C test and the 80F test contain the same words or use the same concepts as the 80E test.

Previous Rulings

8. This Ruling replaces Taxation Rulings IT 97, IT 118, IT 2399 and Canberra Income Tax Circular Memorandum No 857 dated 15 September 1967. The Taxation Rulings will be withdrawn.

Ruling

9. Subject to the operation of the anti-avoidance provisions referred to in paragraph 10 of this Ruling, the requirements in paragraphs 80E(1)(b) and (c) will be satisfied if and only if the company was carrying on at all times during the relevant period (as defined in paragraph 17 of this Ruling) the identical business carried on by the company at the relevant time (as defined in paragraph 18 of this Ruling), and no other business, and during the relevant period the company only derived income from transactions of a kind that it entered into in the course of the operations of that business before the relevant time (see paragraphs 20 to 52 of this Ruling).

10. The section 80E test will not be satisfied by a company if the anti-avoidance provisions in subsection 80E(2) apply. In those anti-avoidance provisions, the reference to 'business' is a reference to the 'same business' carried on by the company for the purpose of satisfying the requirements in paragraphs (b) or (c) of subsection 80E(1). The anti-avoidance provisions will apply where the purpose or one of the purposes of the company in commencing to carry on the business or entering into the transaction was the purpose specified in the anti-avoidance provisions. This is so notwithstanding that, where there is more than one purpose, the specified purpose was not the dominant purpose of the company in commencing to carry on the business or enter into the transaction (see paragraphs 53 to 57 of this Ruling). The anti-avoidance provisions in subsection 80E(2), subsections 50D(5) or 50D(7), or subsection 63C(2) are referred to in this Ruling as the '**anti-avoidance test**'.

11. In paragraph (b) of subsection 80E(1) (or the equivalent provision in the 50D test, the section 63C test and the section 80F test) the meaning of the word 'same' in the phrase 'same business as' import identity and not merely similarity. The phrase 'same business as' is to be read as referring to the same business, in the sense of the identical business. The requirement in paragraph (b) of subsection 80E(1) (or the equivalent provision in the 50D test, the section 63C test and the section 80F test) is referred to in this Ruling as the '**same business test**' (see paragraphs 20 to 23 of this Ruling).

12. In paragraph (c) of subsection 80E(1) (or the equivalent provision in the 50D test, the section 63C test and the section 80F test) there is a reference to 'business of a kind' that the company did not carry on before the relevant time (as defined in paragraph 18 of this Ruling). The words 'business of a kind' means a business other than the 'same business' identified in paragraph (b) of subsection 80E(1). The requirement in paragraph (c) of subsection 80E(1) (or the equivalent provision in the 50D test, the section 63C test and the

section 80F test) relating to 'business of a kind' is referred to in this Ruling as the '**additional business test**' (see paragraphs 44 and 45 of this Ruling).

13. In paragraph (c) of subsection 80E(1) (or the equivalent provision in the 50D test, the section 63C test and the section 80F test) there is a reference to transaction of a kind that the company had not entered into 'in the course of its business operations' before the relevant time (as defined in paragraph 18 of this Ruling). The word 'transaction' refers to any transaction, including the daily transactions involved in carrying on a business and transactions of an isolated or independent kind. The words 'business operations' mean the business operations of the 'same business' identified in paragraph (b) of subsection 80E(1). The requirement in paragraph (c) of subsection 80E(1) (or the equivalent provision in the 50D test, the section 63C test and the section 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**' (see paragraphs 46 to 52 of this Ruling).

Date of effect

14. This Ruling applies to years commencing both before and after its date of issue. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Explanations

Authorities

15. The reported decisions which have dealt with the application of section 80E (or its statutory equivalent) are set out in the *Case References* at the end of this Ruling.

What is the relevant time and the relevant period for the purpose of the same business test?

16. In order for a company to satisfy the same business test, the company must be able to show that it carried on at all times during the relevant period (which is defined in paragraph 17 of this Ruling) the **same business** as the business which the company carried on at the relevant time (which is defined in paragraph 18 of this Ruling).

17. The term '**relevant period**' for the purpose of the same business test is:

(a) in the case of the 80E test - the year of income in which the company seeks to claim a deduction for a prior year loss or part of a prior year loss under section 80E (see paragraph (b) of subsection 80E(1));

(b) in the case of the 50D test:

(i) in the case of applying subsection 50D(4) in respect of a 'subsequent continuous business period' - the period commencing at the end of the loss period and ending at the end of the income period (see the definition of 'subsequent continuous business period' in subsection 50D(8)); or

(ii) in the case of applying subsection 50D(6) in respect of a 'prior continuous business period' - the period commencing at the end of the income period and ending at the end of the loss period (see the definition of 'prior continuous business period' in subsection 50D(8);

(c) in the case of the 63C test - the shorter of:

(i) the period commencing the day after the debt was incurred and ending at the end of the Write Off Year or ending at the end of the Swap Year; and

(ii) the Write Off Year or the Swap Year (see paragraph (b) of subsection 63C(1) and subsection 63C(4));

(d) in the case of the 80F test - the year of income in which the prior year loss or the part of the prior year loss representing the bad debt write off or the swap loss is to be taken into account under sections 79E, 79F, 80, 80AAA or 80AA (see paragraph (f) of subsection 80F(1) and subsection 80F(3)).

18. The term '**relevant time**' for the purpose of the same business test is:

(a) in the case of the 80E test - immediately before a change took place in the beneficial ownership of shares in the company or another company which results in the company not being able under section 80A to claim a deduction for a prior year loss or part of a prior year loss in a year of income (see paragraphs (a) and (b) of subsection 80E(1));

(b) in the case of the 50D test:

(i) in the case of applying subsection 50D(4) in respect of a 'subsequent continuous business period' - the end of the income period (see the definition of 'subsequent continuous business period' in subsection 50D(8)); or

(ii) in the case of applying subsection 50D(6) in respect of a 'prior continuous business period' - the end of the loss period (see the definition of 'prior continuous business period' in subsection 50D(8));

(c) in the case of the 63C test - immediately before a change took place in the beneficial ownership of shares in the company or another company which results in the company not being able under sections 63A or 63B to treat a bad debt written off in a year of income ('**Write Off Year**') as an allowable deduction in the Write Off Year, or to treat a swap loss which arises in a year of income under section 63E ('**Swap Year**') as an allowable deduction in the Swap Year (see paragraphs (a) and (b) of subsection 63C(1) and subsection 63C(4));

(d) in the case of the 80F test - immediately before a change took place in the beneficial ownership of shares in the company or another company which results in the company not being able under sections 63A or 63B to claim a deduction for a bad debt written off in the Write Off Year, or to claim a deduction for a swap loss which arises under section 63E in the Swap Year (see paragraphs (b) and (f) of subsection 80F(1) and subsection 80F(3)).

The same business test

19. The same business test is dealt with in paragraphs 20 to 39 of this Ruling.

What does the same business test mean?

20. *Avondale Motors Pty Ltd v. FC of T* 71 ATC 4101 is a judgment of Gibbs J (as he then was) sitting as a single judge of the High Court and remains the most authoritative judicial statement on the application of section 80E.

21. In *Avondale Motors* Gibbs J made it clear that the reference to 'same business' in section 80E(1)(c) (as it then was) required that the taxpayer carry on the 'identical business' at all times during the relevant period and that the same business test was not satisfied if the

taxpayer carried on a business of the same kind or of a similar kind at any time during the relevant period. Gibbs J said at 4106:

> 'The meaning of the phrase "same as", like that of any other ambiguous expression, depends on the context in which it appears. In my opinion in the context of the section the words "same as" import identity and not merely similarity and this is so even though the legislature might have expressed the same meaning by a different form of words. It seems to me natural to read the section as referring to the same business, in the sense of the identical business, and this view is supported by a consideration of the purposes of the section. The relevant sections of the Act show an intention on the part of the legislature to impose, in the case of companies, a special restriction on the ordinary right of a taxpayer to treat losses incurred in previous years as a deduction from income...This restriction [that is, the continuity of majority beneficial ownership and control tests in sections 80A and 80B] is imposed to prevent persons from profiting by the acquisition of control of a company for the sole purpose of claiming its accrued losses as a tax deduction...No injustice would, in my opinion result from a refusal to treat an accrued loss as a tax deduction where the company after the change carried on a different business, although one of a similar kind. In such a case, as a general rule, there would have been no business reason for the purchase of the shares, but only the wish to obtain the right to claim another's losses as a deduction from one's own income.'

22. The decision of Gibbs J in *Avondale Motors* was expressly approved by Sheppard J in *J Hammond Investments Pty Ltd v. FC of T* 77 ATC 4311 at 4315; by Campbell J in *Fielder Downs (WA) Pty Ltd v. FC of T* 79 ATC 4019 at 4023; and by the New South Wales Court of Appeal in *Boyded (Holdings) Pty Ltd v. FC of T* 82 ATC 4236 at 4239.

23. In *Avondale Motors* the taxpayer company had ceased business completely at the relevant time. However, Gibbs J concluded (see 71 ATC 4101 at 4105) that even if the company's former business had been carried on at the relevant time the taxpayer would not have satisfied the same business limb since during the relevant period 'it carried on the **same kind** of business but under a different name, at different places, with different directors and employees, with different stock and plant and in conjunction with a motor dealer having different franchises' (emphasis added).

Whether the same business is carried on is a question of fact

24. In *Avondale Motors* Gibbs J said (71 ATC 4101 at 4105):

> 'The question whether a company has commenced a new business or has continued an old business under different conditions is simply one of fact.'

25. In *J Hammond Investments* Sheppard J said (77 ATC 4311 at 4315):

> 'The answer to the question of whether the business was the same after the entry into the partnership agreement as it was before involves a factual inquiry; *Avondale Motors*.'

26. The decision of the New South Wales Court of Appeal in *Boyded* is to the same effect. Although there was a question of law involved in the decision of the Board of Review subject to appeal (in the special sense in which that expression was used by the now repealed section 196(1) ITAA), the Court of Appeal agreed with the decision at first instance of Lee J that the question was one of fact. Mahoney JA of the Court of Appeal said (82 ATC 4236 at 4240):

> 'Lee J, in his careful judgment, properly treated the interpretation of the section as established as a matter of law by the *Avondale Motors* decision, in a way which "binds this Court" and he concluded that "thus" what had occurred in the Board hearing was merely the application of an accepted test to the facts of the case.'

In similar circumstances today an appeal from the Administrative Appeals Tribunal would not be competent as subsection 44(1) *Administrative Appeals Tribunal Act 1975* provides for an appeal to the Federal Court by a party to a proceeding before the AAT from a decision of the AAT 'on a question of law'.

Identifying the business carried on by the company at the relevant time

27. The issue of fact to be determined in applying the same business test obviously involves identifying the business carried on by the taxpayer at the relevant time, and determining whether the taxpayer carried on the identical business at all times during the relevant period. In *Fielder Downs* Campbell J held that the taxpayer did not satisfy the same business test since before the relevant time the taxpayer was in the business of growing clover and cereals on land situated in southern Western Australia for sale as seed and grain, and during the relevant period the taxpayer carried on the different business of cattle grazing on the same land. Campbell J said (79 ATC 4019 at 4024):

> 'In my opinion, there is a distinction between the kind or character of a rural business of which the proprietor is described as a pastoralist or a grazier, on the one hand, and one where he is categorised as a producer of, say, fruits, vegetables, fodder or seed, on the other.
> ...
> Although dictionary definitions may be of assistance in some cases, it seems to me that the determination of the issue whether the business carried on by the company in each of the three relevant years was the same business, or one of a similar kind, as was carried on by it before March 1969 depends upon an investigation of fact so as to characterise the kind of nature of the business which was undertaken during each respective period. Before the change the company was engaged in growing clover and cereals for the sale of seed and grain, it was not then growing its clover pasture for the breeding or fattening of stock for sale. In view of the plain words of para (b) of sec 80(1), "The same business as it *carried on* immediately before the change", the fact that, had it continued with the development over a period of time of its pastoral business at Bedford Harbour it would inevitably have gone into the grazing business, the raising or the keeping on the property of large numbers of stock for money-making purposes, does not seem to me to be decisive of the issue. If a business evolves it does not necessarily follow that the essential character of the business is not changed. It would not be difficult to give illustrations in support of this proposition. Moreover, although many business pursuits or occupations may be correctly included in a broad description such as "agricultural", "retailing", etc., they may be substantially different in kind from others which are in the one general category.
> ...
> In my opinion the company did not carry on any grazing or livestock business during the years prior to the change; such livestock as were then on the property were there merely to assist the clover seed production.'

28. In *Case Y45* 91 ATC 426 Dr Grbich of the AAT determined that the taxpayer did not satisfy the 80E test during the relevant period since the taxpayer ceased part of its business which comprised an agency for selling an agricultural machine, notwithstanding that the taxpayer continued its agricultural consulting business at all times. Dr Grbich said (91 ATC 426 at 430):

> 'But Gibbs J does caution that it does not "follow that a business will not be the same" merely because "there have been some changes in the way...it is carried on" [see paragraph 29 of this

Ruling]. This raises "questions of degree". Differences in the nature of the business can eventually pass the point where a qualitative change in the nature of the business takes place. The issue is when that point is reached in a particular case.

The inquiry is basically a factual inquiry but such facts should be analysed in the framework of a principled set of guidelines and previous decisions have gone some way to structure the Tribunal's leeways of choice in the way it characterises particular changes. The following changes have been held sufficient for it to be held the business was not the same as that in the benchmark period.

- Company sells wholesale and retail motor parts and accessories. It disposes of its stock. Eight to nine months later it commences a similar activity with different types of trading stock (*Avondale Motors*);

- Company was a brewer. It ceased brewing but bottled and sold beer brewed by another company (*Gordon & Blair Ltd v. CIR* (1962) 40 TC 358 (Scottish Court of Sessions));

- Company manufactured, sold and installed swimming pools. After the change it merely sold and installed another company's pools (*Case K20*);

- Company was a business offering its land for stock agistment for a fee. After the change it entered into a partnership which conducted a full business of producing wool, lamb and beef (*Case K36* 78 ATC 341; No 1 Board of Review);

- Company was in the business of growing clover and cereals to sell seed and grain. After the change it fattened stock with its seed and grain and became a pastoralist (*Fielder Downs*);

- Before the change the company carried on the business of buying partly finished houseboats, completing construction and selling them. After the change it bought other types of boats, did not carry out construction and sold them (*Case M19*)

- Rolls Royce Motors Ltd produced motor cars and aero engines. The aero engine division was the largest of six divisions. It caused large losses and put the company into financial difficulties. Four divisions of the company (including the ill-fated aero engine division) were hived off to a government owned company by special legislation. The company carried on with the two remaining divisions (*Rolls Royce Motors Ltd v. Balmford* (1976) 51 TC 319; English High Court);

...

The problem [of identifying the business at the relevant time] is

> not to be resolved by empty verbal debates about denotation and connotation of particular labels for the business. Whether the business is to be characterised as an "agricultural investment and management consultant" or as a "general rural entrepreneur" cannot resolve the issue. Such denotation is the end point rather than the foundation on which reasoned decision-making should be constructed...
> [Dr Grbich concluded the taxpayer did not satisfy the same business test]
> ...having regard to the types of changes considered sufficient in the authorities and to the fact that the profits of the...agency were such an important part of the taxpayer company's income-generating activities in its early years, even allowing for the fact that most of the taxpayer's resources were deployed to building up its investment and management advisory services. This was more than a mere change in the process by which it ran its business.'

The decision in *Case Y45* clearly indicates that the discontinuance, whether by way of cessation or sale, of a significant part of the business carried on by the taxpayer during the relevant period will result in the taxpayer not being able to satisfy the same business test of the 80E test, the 50D test, the 63C test or the 80F test.

Expansion or Contraction of Activities

29. A mere expansion or contraction of the taxpayer's business may not result in a change in the identity of the business carried on by the taxpayer. In *Avondale Motors* Gibbs J said (71 ATC 4101 at 4105-4106):

> 'In some circumstances a company may expand or contract its activities, it may close an old shop and open a new one, without starting a new business, but the only conclusion that can be drawn from all the circumstances of the present case is that the business of the taxpayer after 15 March 1968 was different from that which it carried on before that date.
> ...
> It does not, of course, follow that a business will not be the same because there have been some changes in the way in which it is carried on; some cases under sec 80E may give rise to questions of degree which do not arise in the present case.'

30. However, the expansion or reduction of the business activities carried on by the taxpayer may result in a change in the identity of the business carried on by the taxpayer. This was recognised in *Fielder Downs* where Campbell J said (79 ATC 4019 at 4024):

> 'Before the change the company was engaged in growing clover and cereals for the sale of seed and grain, it was not then growing its clover pasture for the breeding or fattening of stock for sale. In view of the plain words of para (b) of sec 80E(1), "The same business as it *carried on* immediately before the change", the fact that, had it continued with the development over a period of time of its pastoral business at Bedford Harbour it would inevitably have gone into the grazing business, the raising or the keeping on the property of large numbers of stock for money-making purposes, does not seem to me to be decisive of the issue. If a business evolves it does not necessarily follow that the essential character of the business is not changed. It would not be difficult to give illustrations in support of this proposition.'

Business must exist at the relevant time and at all times during the relevant period in order to satisfy the same business test

31. In *Avondale Motors* Gibbs J held that the taxpayer company did not satisfy the same business test of the 80E test on the basis that prior to the relevant time, the business activities of the company which comprised dealing in motor vehicle spare parts and accessories, had ceased completely. Gibbs J said (71 ATC 4101 at 4105):

> 'It is further submitted on behalf of the taxpayer that, quite apart from the rather artificial rule to which I have just referred, it should be held that it was still carrying on business after 29 February 1968 notwithstanding its inactivity after that date. It is said that those controlling the taxpayer had no intention of putting it into liquidation and that on the contrary it was obviously their intention that it should again engage in business of a similar kind, after its shares had been sold to a purchaser who wished to benefit by its accrued losses. To say this, however, clearly does not mean that the taxpayer was still carrying on business. There are cases in which it has been held that a company does not cease to carry on business notwithstanding that its activities are reduced to a minimum or indeed are almost entirely suspended. In *South Behar Railway Company Limited v. IR Cmsrs* (1925) AC 476 at 488 Lord *Sumner* said: "Business is not confined to being busy; in many businesses long intervals of inactivity occur". In some cases the very nature of the business is such that its conduct may require little activity, eg. the business...of acquiring a concession and turning it to financial benefit.
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> ...
>
> In other cases it has been held that a company continues to carry

> on business notwithstanding a suspension of activity due to causes beyond its control, e.g. where a steamship company had lost its only ship and was in the course of building another... In the present case the taxpayer's activity had ceased completely. The cessation of activity was not due to the nature of the business which the taxpayer carried on, or to some temporary adversity which the taxpayer intended to endeavour to overcome; it was due to a decision to discontinue the business previously carried on because it had been unprofitable and there was no intention to resume the conduct of that business. The plain fact of the matter is that the taxpayer was not carrying on any business immediately before 15 March 1968. It follows that [the same business test is] not satisfied.'

32. In *Northern Engineering Pty Ltd v. FC of T* 80 ATC 4025 the Full Federal Court upheld the decision of Jenkinson J in the Supreme Court of Victoria that the taxpayer company ceased to carry on its business of trading in vehicles and equipment during the relevant period when the taxpayer disposed of all its trading stock and assets, with the exception of a debt owing by its holding company. Jenkinson J also rejected the taxpayer's argument that at all times during the relevant period the taxpayer was carrying on the business of earning interest on funds lent to the holding company on the basis that 'I am not persuaded that any person concerned in the management or the control or the service of the taxpayer had any expectation or hope, at any time during that year before late June 1967, that the taxpayer would derive income by way of interest on the funds owed to it by [the holding company]' (see 79 ATC 4238 at 4241-4242).

33. In upholding the decision of Jenkinson J, Brennan J of the Full Federal Court in *Northern Engineering* said (80 ATC 4025 at 4027):

> 'The question is whether after the last payment of the price of trading stock was received the appellant continued to carry on until 30 June 1967 a business which it had carried on at the time specified in [paragraph (b) of subsection 80E(1)]. In my judgment the question must be answered in the negative for the reason that no business was carried on after the appellant's trading credits were paid and its trading liabilities discharged. When a company's business is closing down there comes a time when the activity of a trading or profit-making nature comes to an end. The business of the company is not carried on merely by managing or disposing of the company's assets otherwise than in a business.
>
> ...
>
> The depositing or leaving of the appellant's funds with the holding company appears merely to have been a mode of keeping, not of employing, its assets. Merely to preserve assets

> is not, at least in the circumstances of this case, to carry on a business.'

34. In *Northern Engineering* Deane J of the Full Federal Court said (80 ATC 4025 at 4028):

> 'Mr Sweeney relied upon the decision of the House of Lords in *Theophile v. The Solicitor-General* ((1950) AC 186) to support a general proposition that a taxpayer does not cease to carry on business for the purposes of section 80E in its relevant form while any debts remain outstanding either to, or by, him. *Theophile's case* (supra) was concerned with the bankruptcy law and was based on cases in that field. In my view, it cannot be taken as authority for the proposition that a taxpayer is for the purposes of section 80E of the *Income Tax Assessment Act 1936* (in the form applicable to the tax year) carrying on business while so ever any debt owing to him remains uncollected or unpaid.'

35. In *Case U105* 87 ATC 637 Purvis J sitting as President of the AAT determined that the taxpayer had ceased its business of a take-away food shop proprietor 54 days prior to commencing a different business of managing a restaurant/bar/take-away food and coffee shop on different premises during the relevant period. Purvis J said (87 ATC 637 at 641):

> 'This is not a case where the nature of the business required little activity or activity was suspended due to causes beyond the taxpayer's control. The sale of the business and cessation of activity...was attributable to a decision by B on behalf of the taxpayer to discontinue the company's involvement in that business because it had been unprofitable and there was no intention to resume the conduct of that business.'

The business carried on by a company will not be identified by reference to the business carried on by related companies

36. Each company is a separate taxpayer for the purpose of Australian taxation law. The business of a company will be identified, for the purpose of applying the same business test, by reference to the business activities carried on by that company and not by reference to the business activities carried on by a commonly owned or controlled group of companies to which that company belongs. This was expressly confirmed in *Case K20* 78 ATC 184 where the Board of Review said (78 ATC 184 at 187):

> 'It should also be mentioned that we can take no account of the fact, if it be a fact, that the overall business had remained the

same in so far as it was being carried on within a "group" of companies.'

37. The Board of Review in *Case N109* 81 ATC 620 expressed a similar view. At 624 the Board of Review confirmed the general principle that each company is a separate entity for taxation purposes (see also Phillimore J in *Kodak Ltd v. Clark* (1902) 2 KB 450 at 459 and Kitto J in *Hobart Bridge Co Ltd (in liq) v. FC of T* (1951) 9 ATD 273).

Summary of how to determine whether the same business test is satisfied

38. The reported decisions on the application of the 80E test provide the following guidelines in determining whether a taxpayer has satisfied the same business test:

(a) Identifying the business carried on by the taxpayer at the relevant time involves identifying with specificity the actual business activities carried on and transactions entered into by the taxpayer at the relevant time. The business of the taxpayer will not be identified by reference to the kind of industry to which the taxpayer belongs, such as banking, the resources industry, or the information technology industry (see the statements by Campbell J in *Fielder Downs* quoted in paragraph 27 of this Ruling and the statements of Dr Grbich in *Case Y45* quoted in paragraph 28 of this Ruling).

(b) The business carried on by the taxpayer will not be characterised by reference to business activities or transactions which the taxpayer intended to carry on or enter into before the relevant time, or which the taxpayer had power or expressed the intent to carry on or enter into under its constituent documents before the relevant time if the evidence discloses that the taxpayer did not in fact carry on those activities or enter into those transactions before the relevant time (see Sheppard J in *J Hammond Investments* (77 ATC 4311 at 4316)) and Campbell J in *Fielder Downs* quoted at paragraph 27 of this Ruling).

(c) There is a distinction between a change in the business and a 'mere change in the process by which [the business] is carried on' (see Gibbs J *Avondale Motors* quoted at paragraph 29 of this Ruling and Dr Grbich in *Y45* quoted at paragraph 28 of this Ruling). The second kind of change will not of itself result in a taxpayer not satisfying the same business test. However, when a change in the

taxpayer's business operations or processes affects or impacts on the identification of the taxpayer's business in accordance with the principles expressed in the reported authorities and summarised in subparagraphs (a) and (b) of this paragraph 38, the change will go beyond a mere change in the way in which the business is carried on and will result in a change in the business itself.

(d) Although an expansion or contraction of the taxpayer's business activities may not in itself result in a change in the identity of the business carried on by the taxpayer, the expansion or contraction of activities may result in a change in the identity or character of the business taking into account the nature and extent of the expansion or contraction (see paragraphs 29 and 30 of this Ruling).

(e) The discontinuance during the relevant period, whether by way of cessation or sale, of a significant part of the business which was carried on by the taxpayer at the relevant time will result in the company failing to satisfy the same business test (see paragraph 28 of this Ruling and the decisions in *Case K20*, *Case N109*, *Case U105*, and *Case Y45*).

(f) Where the taxpayer's activities had wound down to the extent which justifies a finding of fact that the taxpayer had ceased to carry on a business, either at the relevant time or during the relevant period, the taxpayer will not satisfy the same business test (see paragraphs 31 to 35 of this Ruling).

(g) Each company is a separate taxpayer for the purpose of the application of the ITAA. Accordingly, the business carried on by one company in a commonly owned or controlled corporate group will not be characterised by reference to the business carried on by another company or companies in the same group (see paragraphs 36 and 37 of this Ruling).

39. There are various factors which are relevant to take into account in determining whether the same business test is satisfied by a taxpayer. In some cases a single factor or matter may be so important that it determines the issue but, frequently, it will be a combination of factors, appropriately weighted, which will decide whether the same business is carried on during the relevant period. This process of considering various relevant factors and appraising their significance is adopted by Professor Parsons in *Income Taxation in Australia*, Law Book Company Limited (1985) at paragraphs 10.401 to 10.420. In determining whether the same business test is satisfied, significant

weight will be given to changes after the relevant time in the income producing product of the taxpayer, how it is produced or acquired and/or changes in the market for that product (see Example 1 and Example 2 at paragraphs 58 to 66 of this Ruling).

The additional business test and the new transactions test in the second limb of the 80E test, the 50D test, the 63C test or the 80F test

40. The second limb of the 80E test, the 50D test, the 63C test and the 80F test respectively comprises:

(a) paragraph 80E(1)(c);

(b) paragraphs 50D(4)(a) and (b) and paragraphs 50D(6)(a) and (b);

(c) paragraph 63C(1)(c); and

(d) paragraph 80F(1)(g).

41. The second limb of the 80E test (or the equivalent provision in the 50D test, the 63C test and the 80F test) comprises two separate tests, being the additional business test and the new transactions test (see paragraphs 12 and 13 of this Ruling).

42. The additional business test requires that the taxpayer company did not, at any time during the relevant period, derive income from (or in the case of the 50D test, incur expenditure in carrying on) a business of a kind that it did not carry on before the relevant time (see paragraphs 44 and 45 of this Ruling).

43. The new transactions test requires that the taxpayer company did not, at any time during the relevant period, derive income from (or in the case of the 50D test, incur expenditure as a result of) a transaction of a kind that it had not entered into in the course of its business operations before the relevant time (see paragraphs 46 to 52 of this Ruling).

Additional Business Test

44. In *Avondale Motors* Gibbs J made the following comments in relation to the operation of the second limb of the 80E test (71 ATC 4101 at 4106):

> 'I do not agree with the submission made on behalf of the taxpayer that the construction which I prefer [in relation to paragraph (b) of subsection 80E(1)] gives no effect to the provisions of [paragraph (c) of subsection 80E(1)]. [Paragraph (b) of subsection 80E(1)] requires that the business should be the

> same before and after the change in shareholding; [paragraph (c) of subsection 80E(1)] goes further and deals with the case where the same business is carried on but in addition the company derives income from a business of a different kind or from a transaction of a kind in which it had not previously engaged. An example might be a case in which the company before the change carried on the business of motor dealer and after the change continued to carry on the same business but carried on in addition the business of grocer. The provisions of [paragraph (c) of subsection 80E(1)] seem to me to support the view at which I have arrived rather than to be opposed to it; [paragraphs (b) and (c) of subsection 80E(1)] together show that the legislature intended that where there has been the specified change in the beneficial shareholding of a company the accrued losses can only be treated as deductions if the company after the change was carrying on the same business that it carried on before **and no other business**' (emphasis added).

45. It is clear from the statements of Gibbs J in the above paragraph that even if a company satisfies the same business test in respect of the relevant period, it will fail the additional business test if the company earns income from carrying on a business of a different kind during the relevant period. Example 4 illustrates the operation of the additional business test (see paragraphs 74 to 81 of this Ruling).

New Transactions Test

46. The new transaction test was first considered at length by Sheppard J in *J Hammond Investments*. Sheppard J said (77 ATC 4311 at 4317):

> 'Upon reflection I think it is correct, as both counsel concluded, that the word "transaction" means "dealing".
>
> ...
>
> One could imagine a situation where a company was taken over for the purpose of its tax losses in order to gain the benefit thereof, not for the purpose of offsetting income derived from the business against the losses of previous years, but for the purpose of offsetting against those losses an isolated or chance profit which might have been foreseen, perhaps a profit taxable by reason of the provisions of section 26(a) of the Act or some other income resulting in a chance or isolated profit or gain to the company.
>
> ...
>
> The matters I have so far mentioned do not, however, in my opinion, take the matter sufficiently far to explain the presence in both provisions of the words, "in the course of its business

> operations". But I have come to the conclusion that there is a different type of transaction which probably does explain their presence. There are of course many receipts which are not properly described as being income from a business. There is an example of such a receipt in the present case. The partnership acquired a new building with a tenant in it, who remained in occupation for a short time after the acquisition. The sum of $160 was received by way of rental. It does not seem to me that that was income derived from the business being carried on by the partnership but it was certainly income derived from a transaction entered into in the course of the partnership's business operations. Many other transactions of this general type can be imagined.
>
> Whilst, therefore, I do not regard the matter as free from difficulty, I have reached the conclusion that the second limb of the paragraph is not intended to refer to the daily transactions involved in carrying on a business but to transactions of an isolated and independent kind, which transactions have nevertheless arisen in the course of the taxpayer's business operations.'

47. In *J Hammond Investments* Sheppard J read down the words of the new transactions test so that reference to 'transaction of a kind' did not include a reference to 'daily transactions involved in carrying on a business'. Sheppard J arrived at his interpretation of the new transactions test as a result of his interpretation of the additional business test. However, that interpretation conflicts with the High Court judgment of Gibbs J in *Avondale Motors*. The relevant words of Gibbs J are quoted at paragraph 44 of this Ruling. Particularly important are the following words:

> '[The same business test] requires that the business should be the same before and after the change in shareholding; [the additional business test and the new transactions test] goes further and deals with the case where the same business is carried on but in addition the company derives income from a business of a different kind or from a transaction of a kind in which it had not previously engaged.
> ...
> [The same business test, the additional business test and the new transactions test] together show that the legislature intended that where there has been the specified change in the beneficial shareholding of a company the accrued losses can only be treated as deductions if the company after the change was carrying on the same business that it carried on before **and no other business**' (emphasis added).

In contrast, Sheppard J in *J Hammond Investments* took the following view (77 ATC 4311 at 4317):

> 'One could well have a situation in which a taxpayer, notwithstanding changes in the ownership of its shares, continued to carry on the same business as was carried on immediately before the change, but amalgamated with that business a business of a similar kind. It would still be carrying on the same business within the meaning of paragraph (b) **and also** a business of a similar kind within the meaning of the first limb of paragraph (c)' (emphasis added).

Applying the view of Gibbs J to the hypothetical facts postulated by Sheppard J in the quote immediately above, the company would fail the same business test (because the amalgamated business was not the same business that was carried on at the relevant time) or the company might pass the same business test but would fail the additional business test (because the company not only carried on the same business but also carried on another business).

48. The interpretation propounded by Gibbs J is of higher authority than that of Sheppard J and, with respect, is considered the correct view. Sheppard J relied heavily on his interpretation (which is not accepted) of the role and operation of the additional business test in reaching his conclusion (with 'difficulty') that in the new transactions test the word 'transaction' refers not 'to the daily transactions involved in carrying on a business but to transactions of an isolated and independent kind'. That interpretation is rejected since it was based on a mistaken premise regarding the operation and scheme of the 80E test, and it does not reflect the actual words of paragraph (c) of subsection 80E(1). Furthermore, the view of Sheppard J is also inconsistent with the approach adopted by Campbell J in a later decision (see paragraphs 49 and 50 of this Ruling).

49. In *Fielder Downs* Campbell J indicated a company will fail the new transactions test if the company derives income during the relevant period from a transaction which was of a different kind to the transactions which the company had entered into in the course of the business carried on by the company at the relevant time, **even if the first mentioned transaction is a transaction ordinarily involved in carrying on the business of the taxpayer during the relevant period**. In *Fielder Downs* Campbell J said (79 ATC 4019 at 4025):

> 'If the business carried on beforehand should properly be held to be a business of the development of pastoral land for the eventual grazing of stock and one which was at all material times the one and the same business continuing from its commencement until the lands were fully developed and stocked [**that is, the same business test was satisfied**], it seems to me

that the transaction of selling cattle (or wool or sheep) [**that is, a day to day transaction or a transaction which was entered into in the ordinary course of the taxpayer's business**] was a transaction of a kind that the company had not entered into in the course of its business operations of developing the property prior to the sale. There is a difference in kind between a dealing or transaction concerned with the selling of seed or cereals for income and a dealing involved with obtaining income from the sale of stock.

In *J Hammond Investments Pty Ltd v. FC of T* (supra) Sheppard J at 4318 expressed the view that the [new transactions test] "is not intended to refer to the daily transactions involved in carrying on a business but to transactions of an isolated and independent kind, which transactions have nevertheless arisen in the course of the taxpayer's business operations".

I think that the [new transactions test] contemplates that the transaction not previously carried on was one which could have been carried on in the course of the company's business operations prior to the change-over. Sales of stock had not been carried on prior to that time, and indeed prior to that time the company had no stock available which it could have sold. So, it seems to me, that the sale of stock was a transaction of a different character from any which had been previously entered into by the company.'

50. As illustrated by the words shown in bold in the above quote in *Fielder Downs* Campbell J treated the reference to 'transaction of a kind' in the new transactions test as being a reference to all transactions entered into in the course of the taxpayer's business operations, regardless of whether they were transactions entered into as part of the daily or ordinary conduct of the business carried on by the taxpayer or were transactions which were extraordinary or 'isolated' transactions when judged by reference to the business carried on by the taxpayer. This interpretation of the new transactions test adopted by Campbell J in *Fielder Downs* is considered to be the correct interpretation (see paragraphs 47 and 48 of this Ruling).

51. In order to pass the new transactions test, any transaction from which the taxpayer derived income during the relevant period must be a transaction of a kind which the taxpayer had entered into 'in the course of its business operations', that is, in the course of the **same business** as the business which it carried on at the relevant time (see Campbell J in *Fielder Downs* quoted in paragraph 49 of this Ruling). This requires that the transaction which the taxpayer entered into before the relevant time was relevantly connected with the 'business operations' carried on by the taxpayer at the relevant time. Thus, in

order to apply the new transactions test it is first necessary to characterise the business operations carried on by the taxpayer before the relevant time. The 'business operations' of the taxpayer are identified for the purpose of applying the new transactions test in the same manner that the 'business' of the taxpayer is identified for the purpose of applying the same business limb. In particular, identifying the business operations of the taxpayer for the purpose of applying the new transactions test, involves identifying with specificity the actual business activities carried on by the taxpayer at the relevant time (refer to paragraphs 27, 28 and 38 of this Ruling).

52. In order to show that a transaction was a 'transaction of a kind' which the taxpayer had entered into in the course of the business operations which it carried on at the relevant time, it is not necessary for the taxpayer to show that the transaction was identical to a transaction which the taxpayer had entered into before the relevant time in the course of its business operations. However, a transaction of a different kind to the transaction from which the taxpayer derived income during the relevant period will not be a 'transaction of a kind' for the purpose of the new transactions test. Example 6 indicates the distinction which may be drawn in a particular case between transactions 'of a kind', and transactions of a different kind (see paragraphs 86 to 93 of this Ruling).

The anti-avoidance test

53. Subsection 80E(2), subsections 50D(5) and (7), and subsection 63C(2) contain provisions which are designed to prevent a taxpayer company satisfying the 80E test, the 50D test or the 63C test respectively, where the company commenced to carry on a new business or entered into a new kind of transaction prior to the relevant time in anticipation of obtaining a deduction for a prior year loss, a current year loss or a bad debt respectively. Those provisions are referred to as the '**anti-avoidance test**' (see paragraph 10 of this Ruling).

54. The anti-avoidance test will not be satisfied by a taxpayer where:

(a) before the relevant time, the taxpayer commenced to carry on a business which it had not previously carried on, or entered into, in the course of its business operations, a transaction of a kind which it had not previously entered into; and

(b) the taxpayer commenced to carry on the business or entered into the transaction for the purpose (or for purposes which included the purpose) of satisfying the requirements of the 80E test, the 50D test or the 63C test

(as the case may be) in relation to a prior year loss, a current year loss, or a bad debt or swap loss respectively ('**specified purpose**').

55. There are no reported decisions which clarify the operation of the anti-avoidance test. Nevertheless, the reference to 'business' in the anti-avoidance test is clearly a reference to the 'same business' which the taxpayer carried on at the relevant time for the purpose of applying the same business test of the 80E test, the 50D test or the 63C test, as the case may be (see paragraphs 16 and 21 of this Ruling). Accordingly, the anti-avoidance test will not apply where the taxpayer did not have the specified purpose at the time that it commenced to carry on the 'same business', that is, the business which it was carrying on at the relevant time.

56. Similarly, reference in the anti-avoidance test to a taxpayer entering into 'in course of its business operations...a transaction of a kind' is a reference to a transaction of the kind which it had entered into in the course of the business carried on by the taxpayer at the relevant time (see paragraphs 46 to 52 of this Ruling).

57. Where the taxpayer commenced to carry on the same business or entered into a transaction in the course of its business operations before the relevant time for a variety of purposes, the anti-avoidance test will nevertheless operate to prevent a taxpayer from satisfying the 80E test, the 50D test or the 63C test, as the case may be, where one of the purposes was the specified purpose.

Examples

Example 1

58. During a year of income ending 30 June ('Year 1') a resident company ('Taxpayer'), which is wholly owned by an Australian resident company ('Holding Co'), carries on a business of manufacturing and selling widgets. The Taxpayer sells half of the widgets directly to companies for industrial use by those companies and sells the other half of the widgets to wholesalers who onsell to retailers. The Taxpayer has 1,000 persons employed full time in its business in Year 1. The Taxpayer incurs a loss for Year 1 in the amount of $1M under section 79E(1) ITAA ('Year 1 loss').

59. On 1 July of the year of income next following Year 1 ('Year 2') the shareholders in Holding Co sell all of their shares in Holding Co to an unrelated company resident in the United Kingdom ('UK Parent').

60. In determining whether the Taxpayer carried on the same business at all times during Year 2 (or any later year of income) as was

carried on during Year 1, it is relevant to consider the following matters:

(a) changes in the widget manufactured by the Taxpayer;

(b) whether the Taxpayer commences any other activities in addition to manufacturing the widget (for example, the manufacture of a product which is different to the widget);

(c) changes in the manufacturing activities of the Taxpayer (for example, reduced manufacturing activities arising from the purchase of some parts that were previously manufactured, or the cessation of all manufacturing activities by converting to a purchasing and assembling operation);

(d) changes in the persons to whom the Taxpayer sells the widget (for example, different industrialists or wholesalers);

(e) changes in the mix of customers of the Taxpayer (for example, selling only to wholesalers);

(f) changes in the turnover, profit or gross assets of the Taxpayer attributable to sale of the widgets directly to companies for industrial use or attributable to the sale of the widgets to wholesalers;

(g) changes in the method of selling the widgets (for example, a change from outright sale to sale on consignment, sale on terms, sale by floor plan, or sale by hire purchase or leasing);

(h) changes in the Taxpayer's capital and working capital (for example, the manner and source of finance);

(i) changes in the trade names, trade marks, patents, royalty arrangements or other intellectual property rights of the Taxpayer;

(j) changes in the location or locations where the Taxpayer carries on business and/or changes in the location of the Taxpayer's customers (for example, an expansion or contraction in foreign markets following the takeover by the UK Parent);

(k) reductions or increases in the number of persons employed by the Taxpayer or which are contracted by the Taxpayer to perform services for the Taxpayer, and changes in the nature of services performed by persons who are employed or contracted by the Taxpayer;

(l) changes in the directors and/or management of the Taxpayer.

61. Determining whether the Taxpayer has carried on the same business at all times during Year 2 as the business which the Taxpayer carried on in Year 1 involves drawing an inference of fact after considering and weighing all the factors going to the matters listed in subparagraphs (a) to (l) in paragraph 60 of this Ruling and attaching the appropriate weight to each factor having regard to all the circumstances. Factors which indicate changes in the product, that is, change in the nature of the product or how it is acquired, and changes in the markets, that is, how and to whom the product is sold, will usually be more significant than other factors in the weighing process.

Example 2

62. During a year of income ending 30 June ('Year 1') a resident company ('Taxpayer') is part of a group of companies (the 'Group') which are all wholly owned (directly or indirectly via interposed companies) by an Australian resident company ('Holding Co'). The Taxpayer acted as an in-house financier for the Group. During Year 1 the Taxpayer provided financial accommodation to resident members of the Group and to Holding Co. The Taxpayer obtained the use of funds from companies in the Group, and by way of Australian dollar loans from unrelated Australian banks which were secured by floating charges over assets held by the Group and by guarantees from companies in the Group and from Holding Co. The Taxpayer incurs a loss for Year 1 in the amount of $100M under section 79E(1) ITAA ('Year 1 loss').

63. On 1 July of the year of income next following Year 1 ('Year 2') the shareholders in Holding Co sell all of their shares in Holding Co to an unrelated company resident in Hong Kong ('Hong Kong Parent').

64. In determining whether the Taxpayer carried on the same business at all times during Year 2 (or any later year of income) as was carried on during Year 1, it is relevant to consider the following matters:

(a) changes in the financial accommodation or the mix of financial accommodation provided by the Taxpayer (for example, subscribing for redeemable preference shares in addition to or in substitution for making loans, making interest free unsecured loans in addition to or in substitution for making loans at interest, or commencing to provide accommodation in new foreign currencies);

(b) whether the Taxpayer commences any other activities in addition to providing financial accommodation (for

example, commencing to enter into financial arrangements for the purpose of hedging foreign investments and/or liabilities of its own or of companies in the Group);

(c) whether the Taxpayer reduces or terminates an activity (for example, ceasing to provide accommodation by way of unsecured loans at interest);

(d) changes in the market of the Taxpayer, that is, changes in the persons to whom the Taxpayer lends funds (for example, commencing to provide financial accommodation to new customers such as companies wholly owned by Hong Kong Parent which were not companies which were members of the Group in Year 1, ceasing to provide accommodation to companies which have ceased to be members of the Group, or a significant alteration in the proportion of dealings with particular customers);

(e) changes in the turnover, profit or gross assets of the Taxpayer attributable to the different kinds of transactions which are entered into by the Taxpayer;

(f) changes in the geographical location or focus of the Taxpayer's activities (for example, changes in the location of the Taxpayer's premises or where the Taxpayer's activities occur);

(g) changes in the source of funds of the Taxpayer or the way in which it raises those funds (for example, issuing promissory notes to a tender panel of international banks in addition to or in substitution for domestic borrowings from Australian banks, or borrowing at interest from a non-related trust or significant raising of share capital in addition to or in substitution for interest free deposits from companies in the Group);

(h) significant alterations in the securities associated with the financial dealings of the Taxpayer (for example, the removal of restrictions on gearing or the scope of the activities of the Taxpayer imposed under the terms of any debenture issued by the Taxpayer, or the creation of such restrictions);

(i) reductions or increase in the number of persons employed by the Taxpayer or which are contracted by the Taxpayer to perform services for the Taxpayer, and changes in the nature of services performed by persons who are employed or contracted by the Taxpayer;

(j) changes in the directors and/or management of the Taxpayer.

65. Determining whether the Taxpayer has carried on the same business at all times during Year 2 or any later year of income as the business which the Taxpayer carried on in Year 1 involves drawing an inference of fact after considering and weighing all the factors going to the matters listed in subparagraphs (a) to (j) in paragraph 64 of this Ruling and attaching the appropriate weight to each relevant factor having regard to all the circumstances. Factors which indicate a change in the nature of the income generating transactions or the persons with whom the Taxpayer enters into those transactions will usually be more significant than other factors in the weighing process. Where the business of the Taxpayer consists of dealings with related companies, significant changes in the identity or business of the related companies may have an important effect on the nature of the Taxpayer's dealings with those companies, and thus, on the nature of the income producing transactions of the Taxpayer.

66. For example, where a shift of the Taxpayer's head office to Hong Kong during Year 2 is associated with the following events or circumstances:

(a) appointment of a new Hong Kong management of the Taxpayer;

(b) a new focus on borrowings by the Taxpayer in US dollars from Hong Kong banks with novel security arrangements necessitated by the requirements of new customers of the Taxpayer (such as a Malaysian manufacturing company which became a new member of the Group during Year 2);

(c) entry by the Taxpayer into a debt defeasance to eliminate a debenture issued by the Taxpayer to an Australian resident company securing an Australian dollar borrowing by the Taxpayer and which results in the removal of constraints imposed under the terms of the debenture;

(d) the cessation by the Taxpayer of dealings with a resident company which ceased to be a member of the Group during Year 2 and to which the funds borrowed by the Taxpayer under the debenture referred to in subparagraph (c) of this paragraph 66 had been lent,

consideration and weighing of all of the factors going to the matters listed in subparagraphs (a) to (j) of paragraph 64 of this Ruling would lead to the conclusion that the Taxpayer did not carry on the same business at all times during Year 2 as the business which it carried on during Year 1. This is not to say that the absence of one or more of

the events or circumstances described in paragraphs (a) to (d) of this paragraph 66 would lead to a different conclusion.

Example 3

67. During a year of income ending 30 June ('Year 1') a resident company ('Taxpayer') owned and operated a restaurant which was located in a Sydney suburb and which served a distinctive style of Northern Japanese cuisine. The name of the restaurant reflected the style of the cuisine and the name was a registered tradename of the Taxpayer. The management and service methods employed by the Taxpayer in operating the restaurant and the decor and the fit out of the restaurant were suitable for franchise. During the whole of Year 1 the Taxpayer was wholly owned and controlled by the original shareholders. The Taxpayer incurs a loss for Year 1 in the amount of $20,000 under section 79E(1) ITAA ('Year 1 loss').

68. On 1 July of the year of income next following Year 1 ('Year 2') the original shareholders sold all their shares in the Taxpayer to new shareholders.

69. During Year 2 the Taxpayer continues to own and operate the Japanese restaurant ('Original Japanese Restaurant'). During Year 2 the Taxpayer also purchases an Italian restaurant from an unrelated party which is carried on in leased premises located in another suburb in Sydney which is twenty kilometres from the suburb in which the Original Japanese Restaurant is located.

70. In Scenario 1, the Taxpayer commences to operate the Italian restaurant during Year 2.

71. For the purpose of applying the same business test and the additional business test to Scenario 1, it would be concluded that in commencing to operate the Italian restaurant the Taxpayer was commencing to carry on a business in Year 2 which was different to the business which the Taxpayer carried on at the end of Year 1. Accordingly, in Scenario 1 the $20,000 loss incurred in Year 1 would not be deductible in Year 2 (see paragraphs 11, 12, 21, 27, 28, 38, 44 and 45 of this Ruling).

72. In Scenario 2, the Taxpayer never operates the Italian restaurant and converts the premises where the Italian restaurant is located into a restaurant serving Japanese food ('Second Japanese Restaurant'). During Year 2 the Taxpayer commences to operate the Second Japanese Restaurant. The Second Japanese Restaurant uses the same registered tradename as the Original Japanese Restaurant and the menu of the Second Japanese Restaurant is identical to the menu of the Original Japanese Restaurant. The fit out and decor of the Second Japanese Restaurant is identifiable with the fit out and decor of the

Original Japanese Restaurant. The Second Japanese Restaurant is operated using the same management and service methods as the Original Japanese Restaurant.

73. For the purpose of applying the same business test to Scenario 2, it would be concluded that in commencing to operate the Second Japanese Restaurant in the manner described in paragraph 72 of this Ruling the Taxpayer was merely expanding the same business which the Taxpayer carried on at the end of Year 1 (see paragraphs 29 and 30 of this Ruling). The Taxpayer therefore carried on the same business in Year 2 as it carried on in Year 1 and no other business. Accordingly, the Taxpayer will satisfy the same business test and the $20,000 loss incurred in Year 1 would be deductible in Year 2.

Example 4

74. During a year of income ending 30 June ('Year 1') a resident company ('Taxpayer') carried on a Holden new and used car dealership located in Brisbane, which included dealing in spare parts and after sales servicing of customers ('Holden Dealership'). During the whole of Year 1 the Taxpayer was wholly owned and controlled by an individual. The Taxpayer incurs a loss for Year 1 in the amount of $50,000 under section 79E(1) ITAA ('Year 1 loss').

75. On 1 July of the year of income next following Year 1 ('Year 2') all shares in the Taxpayer were sold to another individual.

76. In Scenario 1, during Year 2 the Taxpayer terminates its dealership agreement with Holden and ceases to purchase Holden new and used cars for resale and commences to deal in Ford new and used cars from the same location in Brisbane.

77. For the purpose of applying the same business test to Scenario 1, it would be concluded that the Taxpayer did not carry on at all times during Year 2 the same business which the Taxpayer carried on at the end of Year 1 (see paragraphs 11, 21, 27, 28 and 38 of this Ruling). Accordingly, the $50,000 loss incurred in Year 1 would not be deductible in Year 2.

78. In Scenario 2, during Year 2 the Taxpayer continues to carry on the Holden Dealership and also commences to carry on a BMW new and used car dealership located in Brisbane which includes dealing in spare parts and after sales servicing of customers ('BMW Dealership').

79. The same business test and the additional business test would have to be considered in Scenario 2. The Taxpayer would fail the same business test if it was determined that the Taxpayer was carrying on one business during Year 2 which included both the Holden Dealership and the BMW Dealership, because that business would not

be the same business as the business of the Holden Dealership carried on at the end of Year 1. However, the Taxpayer would fail the additional business test if it was determined that the BMW Dealership comprised a separate business in itself, because that separate business would constitute a business other than the business which the Taxpayer carried on in Year 1. Accordingly, the $50,000 loss incurred in Year 1 would not be deductible in Year 2 (see paragraphs 11, 12, 21, 27, 28, 38, 44 and 45 of this Ruling).

80. In Scenario 3, during Year 1 the Taxpayer carries on the Holden Dealership and the BMW Dealership. However, during Year 2 the Taxpayer disposes of the BMW Dealership to an unrelated party.

81. For the purpose of applying the same business test to Scenario 3, it would be concluded that in disposing of the BMW Dealership in Year 2 the Taxpayer did not carry on at all times during Year 2 the same business which it carried on at the end of Year 1. The Taxpayer would fail the same business test if it was determined that the Taxpayer was carrying on one business at the end of Year 1 which included both the Holden Dealership and the BMW Dealership since the discontinuance of a significant part of the business during Year 2 will result in the Taxpayer failing the same business test (see subparagraph (e) of paragraph 38 of this Ruling). However, if in Year 1 the BMW Dealership and the Holden Dealership comprised two separate businesses, the Taxpayer would also fail the same business test because ceasing that separate business of the BMW Dealership during Year 2 will mean that at all times during Year 2 the Taxpayer did not carry on each of the same businesses which the Taxpayer carried on at the end of Year 1. Accordingly, the $50,000 loss incurred in Year 1 would not be deductible in Year 2 (see paragraphs 11, 21, 27, 28 and 38 of this Ruling).

Example 5

82. During a year of income ending 30 June ('Year 1') a resident company ('Taxpayer') carried on a mining operation in Australia. During Year 1 the Taxpayer's activities consisted of mining iron ore in Australia and selling the iron ore to customers located throughout the world. During Year 1 all of the assets of the Taxpayer were dedicated to its iron ore mining and extraction activities. During the whole of Year 1 the Taxpayer was wholly owned and controlled (via interposed companies) by an Australian resident public company ('Holding'). The Taxpayer incurs a loss for Year 1 in the amount of $10M under section 79E(1) ITAA ('Year 1 loss').

83. On 1 July of the year of income next following Year 1 ('Year 2') Holding sold all of its shares in the Taxpayer to an unrelated Japanese resident company.

84. During Year 2, the Taxpayer continued to carry on the iron ore mining and extraction operations which it carried on during Year 1. During Year 2 the Taxpayer also commenced gold mining activities in another Australian location. Those gold mining activities involved mining ore, extracting gold from the ore and selling the extracted gold to customers located throughout the world. During Year 2, 60% of the gross value of the assets of the Taxpayer were dedicated to its iron ore mining and extraction activities and 40% of the gross value of the assets of the Taxpayer were dedicated to its gold mining and extraction activities.

85. For the purpose of applying the same business test and the additional business test , it would be concluded that in commencing to carry on the gold mining and extraction activities the Taxpayer had commenced during Year 2 to carry on a business of different kind to the business which it carried on at the end of Year 1. Accordingly, the $10M loss incurred in Year 1 would not be deductible In Year 2 (see paragraphs 11, 12, 21, 27, 28, 38, 44 and 45 of this Ruling).

Example 6

86. During a year of income ending 30 June ('Year 1') a resident company ('Taxpayer') carried on a gold mining operation in an Australian location. That operation involved mining ore, extracting gold from the ore and selling the extracted gold to customers located throughout the world. During the whole of Year 1 the Taxpayer was wholly owned and controlled by an Australian resident company ('Goldco'). The Taxpayer incurs a loss for Year 1 in the amount of $5M under section 79E(1) ITAA ('Year 1 loss').

87. On 1 July of the year of income next following Year 1 ('Year 2') Goldco sold all of its shares in the Taxpayer to an unrelated United Kingdom resident public company.

88. In Scenario 1, the business plan of the Taxpayer during Year 1 included a business strategy in relation to the sale of copper ore which was being mined as a result of the gold mining operations carried on by the Taxpayer. Implementation of that business plan resulted in the Taxpayer entering into contracts for the sale of copper ore in the future at the fixed price specified in the contracts and negotiating with potential customers of copper ore during Year 1.

89. In Scenario 2, the Taxpayer had no business plan or strategy in place during Year 1 in relation to the sale of copper ore which was being mined as a result of the gold mining operations carried on by the

Taxpayer and the Taxpayer did not enter into any formal agreements, arrangements or negotiations in relation to the future sale of copper ore. In Scenario 2 the Taxpayer had a general intention during Year 1 to sell copper ore in the future in the event that there was, in the Taxpayer's opinion, a sufficient improvement in the concentration of copper in the ore which was being mined as a result of the gold mining operations carried on by the Taxpayer and/or a sufficient increase in the world price for copper ore.

90. In both Scenario 1 and Scenario 2, the Taxpayer continued to carry on during Year 2 the gold mining and extraction operations which it carried on during Year 1. In both Scenario 1 and Scenario 2, the Taxpayer also sold copper ore during Year 2 which it had mined during Year 1 or which it mined during Year 2 from the same location.

91. In Scenario 2, the Taxpayer commenced to sell copper ore in Year 2 because of a significant increase during Year 2 in the world price for copper ore.

92. For the purpose of applying the same business test to Scenario 1, it would be concluded that in selling copper ore during Year 2, the Taxpayer was merely expanding the same business which the Taxpayer carried on at the end of Year 1 (see paragraphs 29 to 30 of this Ruling). In addition, for the purpose of applying the new transactions test to Scenario 1, it would be concluded that in selling copper ore during Year 2 the Taxpayer was not deriving income during Year 2 from a transaction of a kind that the Taxpayer had not entered into in the course of the same business which the Taxpayer was carrying on at the end of Year 1 (see paragraphs 13 and 46 to 52 of this Ruling). Accordingly, in selling copper ore during Year 2 the Taxpayer will satisfy the same business test and the new transactions test and the $5M loss incurred in Year 1 would be deductible in Year 2.

93. For the purpose of applying the new transactions test to Scenario 2, it would be concluded that in commencing to sell copper ore during Year 2 the Taxpayer was deriving income during Year 2 from a transaction of a kind that the Taxpayer had not entered into in the course of the same business which the Taxpayer was carrying on at the end of Year 1 (see paragraphs 13 and 46 to 52 of this Ruling). Accordingly, in commencing to sell copper ore during Year 2 the Taxpayer will not satisfy the new transactions test and the $5M loss incurred in Year 1 would not be deductible in Year 2.

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