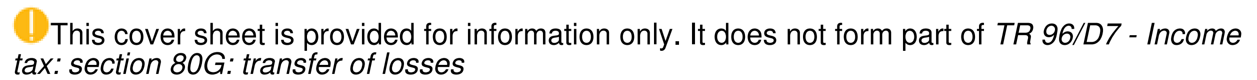
TR 96/D7 - Income tax: section 80G: transfer of losses



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Australian Taxation Office

Draft Taxation Ruling
Income tax: section 80G: transfer of losses

other Rulings on this topic

IT 2465; IT 2624; IT 2636; TD 22; TD 93/120

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What this Ruling is about

Class of person/arrangement

1. This Ruling is concerned with the transfer of losses, incurred in 1984-85 or subsequent years of income, within a wholly owned company group pursuant to section 80G of the *Income Tax Assessment Act 1936* (the Act). It describes the operation of section 80G, and where relevant, section 160ZP of the Act. It does not consider the definition of 'group company' in subsections 80G(1) to 80G(5B).

Date of effect

2. 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).

Previous Rulings

3. This Ruling supplements the Commissioner's earlier opinion on section 80G expressed in Taxation Ruling IT 2465. This Ruling does not withdraw IT 2465 except to the extent of any inconsistency.

Definitions

4. In this Ruling the following definitions have been used:

divisional company: a single company operating along divisional lines;

formula document: any transfer document transferring a right to an allowable deduction in respect of a loss which does not specify the actual dollar amount of the loss to be transferred;

group company: refer to paragraphs 32 and 33 below;

income company: a resident company transferee of losses;

loss: a loss calculated in accordance with a loss provision (sections 79E, 79F, 80, 80AAA or 80AA) at a time relevant under section 80G, and does not necessarily refer to the amount of that loss as is finally determined;

loss company: a resident company transferor of losses;

loss deduction: a right to an allowable deduction in respect of a loss;

net assessable income: the sum of assessable income and net exempt income less allowable deductions in a year of income;

subvention payment: a payment made in respect of the transfer of a loss deduction;

taxable income: assessable income less allowable deductions as calculated in accordance with section 48 of the Act;

transfer document: a notice or an agreement in writing pursuant to section 80G.

Ruling

5. Section 80G of the Act operates to enable resident companies with losses to transfer the right to an allowable deduction in respect of those losses to other resident companies within the same group. This transfer is effected by a transfer document between the loss company and the income company. The provisions of subsections 80G(6) through to 80G(19) govern the process by which loss deductions are transferred.

Nature of agreements

6. An agreement to transfer a loss deduction under section 80G is effective when the conditions laid down in subsections 80G(6) and (6A) have been satisfied. These conditions include the ascertainment of a loss within the loss company and net assessable income within the income company at the time of making the agreement, the existence of

a group relationship between the companies, and the formal requirements of writing and signing by the public officers of each company. The validity of transfer documents does not depend upon compliance with principles of contract law. Accordingly, these principles will not be relevant to affect the validity of an agreement where there has been compliance with the statutory requirements of subsections 80G(6) and (6A). It is compliance with these requirements which triggers the deeming provisions in subsections 80G(6) and (12) to transfer effectively the loss from the loss company to the income company.

Further transfers

7. The provisions of section 80G indicate that there is a degree of flexibility in the loss transfer process. The section is only invoked with the agreement of the relevant loss company and income company which means that the loss company will always have the option to carry forward the loss itself for future recoupment. The section also provides that parts of a loss may be transferred and that these parts may be transferred to a number of income companies within the group to the extent of the total amount of loss available for transfer. This is the effect of subsection 80G(13).

8. A loss company may also enter into a further transfer document with an income company to which it has already transferred a part of its loss in the relevant income year. This is on the condition that a part of the total loss remains available for transfer and there is sufficient net assessable income within the income company to absorb the additional transfer. Further transfer documents must be effected before the date of lodgment of the relevant return of the income company or within such further time as the Commissioner allows.

Revocation

9. Although section 80G provides a degree of flexibility in the treatment of losses, there is no provision within section 80G which permits the revocation of a valid transfer document. The combined operation of subsections 80G(6) and (12) indicates that an amount of loss is deemed to have been incurred by the income company and not to have been incurred by the loss company once the conditions of section 80G have been satisfied. This means that the relevant amount of loss is no longer available to be dealt with by the loss company.

10. There is no provision in section 80G which enables a loss to be transferred back from an income company to a loss company. Furthermore, there are specific provisions within section 80G which deal with the partial invalidity and variation of transfer documents in

the event of changed circumstances of either the loss company or the income company (specifically subsections 80G(7), (15) and (16)). This supports the view that the section operates to uphold the validity of transfer documents where possible and is inconsistent with a general right of revocation.

Specificity of transfer documents

11. The words and operation of section 80G indicate that only transfer documents which nominate a fixed dollar amount of loss are contemplated by the section. The provisions within section 80G which refer to the content of a transfer document use the words 'amount specified' in reference to the loss transferred under that document. Formula documents, which are capable of varying the amount transferred by reference to a formula as circumstances change in the loss company or the income company, cannot be said to have effected a transfer of a **specified amount** of loss and are, therefore, ineffective.

12. It has been suggested that a formula document does effect a loss transfer because the formula will result in an 'amount specified' in the future when the facts are clarified in respect of the final tax position of the respective companies. This view is not supported by the Commissioner because:

(i) it would preclude the proper operation of the deeming provisions in subsections 80G(6) and (12);

(ii) it would eliminate the effectiveness of subsections 80G(7), (15) and (16); and

(iii) it would preclude the loss company from entering into additional loss transfer documents in terms of subsection 80G(13).

13. Firstly, subsections 80G(6) and (12) deem an amount of loss to have been incurred by the income company and not to have been incurred by the loss company when a transfer document has been executed. If that amount is not ascertainable until facts are clarified in the future then no deeming could occur. Therefore, section 80G would not take effect to transfer a loss deduction until that later time and tax would be payable by the income company in respect of the income year. This interpretation is not supported because it is contrary to the policy behind section 80G to provide tax relief to the income company in the income year.

14. Secondly, although a formula document may give an 'amount [of loss] specified' in the future when the tax position of the respective companies is finally determined, this interpretation would render

otiose the amending subsections 80G(7), (15), and (16). These amending subsections operate to alter the amount specified in a transfer document as circumstances change in the respective companies. Therefore, the correct interpretation is that the 'amount [of loss] specified' in a transfer document is the amount determined on the basis of the tax position of the respective companies at the time of executing the transfer document.

15. Thirdly, subsection 80G(13) provides that a loss company can only enter into further transfer documents in respect of the balance of loss remaining after subtracting from its total loss the sum of the amounts specified in any previous loss transfer documents. The use of a formula document precludes the loss company from ascertaining the balance of its loss remaining until such time as the tax position of the respective companies is finally determined. This would prevent the loss company from entering into further loss transfer documents - a result inconsistent with the policy of immediate tax relief behind section 80G.

Commissioner's treatment

16. A transfer of a loss deduction will only be effective if and when there is an 'amount [of loss] specified'. However, upon execution, a formula document generally results in an amount specified equivalent to the amount of loss claimed as a deduction in the income tax return of the income company. In these circumstances the Commissioner will accept a formula document as being valid to transfer that amount only. No subsequent adjustment of that amount in accordance with the formula document will be accepted.

Exercise of the discretion under subsection 80G(6A)

17. Under subsection 80G(6A), a loss transfer agreement is required to be made before the date of lodgment of the return of the income company **or within such further time as the Commissioner allows**.

18. In exercising the discretion under subsection 80G(6A), the Commissioner is obliged to comply with administrative law principles. This means that there is an obligation to identify and consider all factors which may be relevant to the exercise of the discretion and to give them an appropriate weighting. In determining the relevant factors and their weighting, the Commissioner will have regard to the policy of section 80G and its context within the Act. Although each case must be decided on its merits, this Ruling provides a guide to taxpayers and officers of the ATO as to what factors may be relevant to the exercise of the discretion.

19. In cases where there has been delay on the part of the relevant companies in effecting an agreement, the principles outlined in *Hunter Valley Developments Pty Ltd & Ors v. Cohen* (1984) 58 ALR 305; (1984) 7 ALD 315; (1984) 3 FCR 344 (*Hunter Valley Developments*) and subsequent supporting authorities in respect of statutory discretions to extend time will be relevant to the subsection 80G(6A) discretion. Following *Hunter Valley Developments*, the statutory time limit is not to be ignored and, *prima facie*, agreements must be made within time. Therefore, the onus will be on the taxpayer to convince the Commissioner that the case is an appropriate one for the favourable exercise of the discretion. This will generally require the taxpayer to provide an adequate explanation for the delay.

20. In cases where an agreement is sought to be made out of time as a result of an adjustment to the tax position of the company group by the Commissioner, a relevant factor will be the conduct of the group giving rise to the adjustment. Where there is fraud or evasion on the part of the group, or a scheme to which Part IVA of the Act applies, then these factors will weigh heavily against a favourable exercise of the discretion. Where an adjustment results from the failure to take a reasonably arguable position (where appropriate) or reckless behaviour, so that the imposition of penalty tax under Part VII of the Act is warranted, these factors will be similarly relevant. Conversely, where an adjustment stems from conduct which could not be regarded as tainted or culpable, this factor will be weighted in favour of the extension of time being granted.

Explanations

History and policy

21. The amendments to allow a transfer of losses within a company group can be traced to the *Final Report of the Committee of Enquiry on the Australian Financial System - 1981* (Campbell Committee Report). Submissions were made to the Committee proposing that a group of companies should be taxed as a single entity. The submissions were mainly based on the treatment of tax losses.

22. At the time, the Act provided that a tax loss could only be carried forward for deduction against future taxable profits for up to seven years (excepting primary production losses). Company groups with common ownership, having both profitable and unprofitable enterprises, were unable to offset losses made by one company against the profits of another. In some circumstances, the losses were forfeited before they could be recouped. In this way, a company group

was said to be treated unfairly in comparison with a divisional company.

23. The Campbell Committee Report recommended two options:

(i) taxation of company groups as one entity; or

(ii) allowing the transfer of losses within company groups.

Section 80G reflects the implementation of the second option.

24. The thrust of the Committee's findings is relevant to understanding the policy behind section 80G. However, this policy background cannot override the clear or express words of the statute. In this regard, it is relevant to point out that section 80G may give an advantage to a company group over a divisional company since there is no requirement for the company group to deduct losses in the year in which they are incurred. The company group has the options of:

(i) leaving the loss in the loss company to be carried forward for its own future use or future transfer to another group company; or

(ii) causing the loss to be transferred (in whole or in part) to another company within the group which has sufficient net assessable income to absorb the loss.

Therefore, section 80G must be read as putting the company group on a comparative, but not necessarily equal, footing to a divisional company.

General outline of the operation of section 80G

25. Broadly, section 80G allows a transfer of the right to an allowable deduction in respect of a loss from a resident company with losses (the loss company) to another resident company (the income company) where the following conditions are satisfied:

(i) the loss company has incurred a loss;

(ii) the income company has net assessable income, or, but for the operation of section 80G, would have net assessable income;

(iii) the loss company and income company agree that the right to an allowable deduction in respect of that loss is to be transferred; and

(iv) the loss company is a group company in relation to the income company.

Losses

26. The loss company must have incurred a loss (paragraph 80G(6)(a)). The loss company must offset any prior year losses against its own net assessable income in the current year before a loss can be transferred to the income company (subsection 80G(10)).

27. Section 80G does not change the general rule that a company with unused prior year losses must offset the losses in the order in which they are incurred against its own net assessable income before transferring the losses to an income company in the group. Losses transferred to a group company must also be transferred in the order in which they are incurred (subsection 80G(11)).

Taxable income

28. The income company must have, or would have but for the operation of section 80G, a taxable income in the year of income in which the loss that has been transferred will be deducted. Therefore, the income company will need to ascertain whether or not it has a taxable income in terms of the calculation under section 48 (paragraph 80G(6)(b)).

Residence

29. The loss company must be a resident in the year of income in which the loss is incurred whilst the income company must be a resident in the year of income in respect of which the loss is transferred (subsection 80G(6)).

Agreement

30. The loss company and the income company must agree that the loss deduction is to be transferred. The loss in respect of which the agreement is made cannot have been the subject of a deduction to the loss company or another group company in the year of income in which the deduction is to be allowed or an earlier year.

31. The agreement must be in writing and made before the date of lodgment of the return of income of the income company. The Commissioner has a discretion to allow further time for the making of the agreement.

Group company

32. The transfer only applies where the loss company is a group company in relation to the income company during the whole of the:

(i) loss year;

(ii) income year; and

(iii) any intervening year.

33. One company must be a wholly owned subsidiary (directly or indirectly) of the other, or both must be wholly owned subsidiaries of the same company (subsection 80G(1)).

Varying the amount specified in the agreement

34. Although subsection 80G(6) operates to transfer the loss deduction to the income company, section 80G also operates to vary the amount specified in an agreement in the circumstances outlined below - see also the Examples at paragraphs 110-115 below.

35. An agreement will not have effect to the extent that the amount specified in the transfer document exceeds the net assessable income of the income company (subsection 80G(7)). Therefore, where it is found that a deduction is not allowable to the income company in respect of the whole amount of the loss specified in the transfer document, subsection 80G(16) will apply as if the amount which is allowable as a deduction had been specified in the transfer document.

36. Where, subsequent to the loss transfer, it is found that the whole or part of the transferred loss was not incurred by the loss company, the Commissioner is empowered to disallow the whole or part of the deduction to the income company. The deduction will be reduced to an amount which reflects the actual amount of loss that was available to be transferred (subsection 80G(15)). The transfer document is treated as specifying the amount of loss allowed as a deduction after the application of subsection 80G(15). Further, nothing in section 170 prevents an amendment to an assessment to effect the reduction.

Further agreements

37. Once an agreement to transfer part of a loss is made, the loss company is precluded from making further agreements which purport to transfer a loss deduction for an amount greater than the balance of the loss. The balance of the loss is calculated as the total loss incurred by the loss company reduced by the sum of the amount(s) specified in any earlier transfer document(s) (subsection 80G(13)).

Similar provisions in section 160ZP

38. In respect of Part IIIA of the Act, net capital losses are calculated pursuant to section 160ZC. Section 160ZP allows the transfer of net

capital losses within a wholly owned company group in broadly the same way as section 80G. To the extent that the principles in section 80G and section 160ZP are the same, the discussion of the elements of section 80G can be equally applied to section 160ZP.

Notices and agreements

39. Prior to 1 July 1992, the transfer of a loss deduction was effected by a **notice** pursuant to the former paragraph 80G(6)(c) as follows:

> '... the loss company and the income company give to the Commissioner, on or before the date of lodgment of the return of income of the income company for the income year or within such further time as the Commissioner allows, a notice in writing signed by the public officer of each of those companies ...'

40. With the introduction of self-assessment for companies, the legislation was amended, effective from 1 July 1992, and provided that **agreements** between the loss company and the income company would replace the requirement of the provision of a **notice** to the Commissioner. This amendment is expressed in subsection 80G(6A) as follows:

> 'An agreement under paragraph (6)(c) must be:
>
> (a) in writing and signed by the public officer of each of the loss company and the income company; and
>
> (b) made before the date of lodgment of the return of income of the income company for the income year or within such further time as the Commissioner allows.'

41. Agreements are not required to be lodged with the Commissioner. However, notices were previously required to be lodged **on or before** the date of lodgment of the return of the income company, whilst agreements must be made **before** the date of lodgment of the income company's return, or within such further time as the Commissioner allows.

42. All transfer documents must be:

(i) in writing; and

(ii) signed by the public officers of each of the loss company and the income company.

On this basis, where a loss is transferred in respect of an income year subsequent to 30 June 1992, it must be effected by an **agreement**.

Nature of 'agreements' under subsection 80G(6)

43. The validity of an agreement pursuant to subsection 80G(6) is not governed by the principles of contract law. The word 'agree' in paragraph 80G(6)(c) appears in the context of ordinary language and the legislature has avoided the use of technical phrases which may otherwise connote a legal contract. The relevant words used in paragraph 80G(6)(c) are:

> 'the loss company and the income company agree that the right to an allowable deduction ... should be transferred to the income company in the income year.'

44. Subsection 80G(6A) provides that an **agreement** under paragraph 80G(6)(c) must be both in writing and signed by the public officer of each company. It is considered that 'agree' in this provision is not used in a contractual sense.

45. The fact that the word 'agreement' was not part of section 80G, prior to 1992, further indicates that the transfer document need not be contractual in nature. The Explanatory Memorandum which accompanied the introduction of subsection 80G(6A) confirms that agreements were only introduced to replace 'notifications of transfer' for the purpose of facilitating full self-assessment principles. The requirement of a written and signed agreement simply serves as evidence of the decision to transfer losses should the Commissioner subsequently require verification of the transfer.

46. Section 80G is not predicated upon the existence of consideration as a prerequisite to the making of an effective loss transfer agreement. Subsections 80G(17) and (18) merely provide for those circumstances where subvention payments are, in fact, made in respect of a transfer of a loss deduction. This is in contrast with the requirements for an agreement in subsections 80G(6) and (6A). It is not denied that a legally enforceable contract may arise in the guise of the agreement referred to in subsections 80G(6) and (6A) (e.g., because the agreement is supported by valuable consideration in the form of a subvention payment). However, the **validity** of the transfer document does not depend upon the agreement being legally enforceable. It is compliance with the requirements of subsections 80G(6) and (6A) which creates an effective agreement, and the force of statute which **deems** the loss to be incurred by the income company when these requirements have been fulfilled.

Revocation

47. An agreement that is effective in transferring the right to an allowable deduction in respect of a loss cannot subsequently be

revoked. This result comes from the nature of section 80G and in particular:

(i) the meaning of the word 'agreement' and the amending provisions (subsections 80G(7), (15) and (16));

(ii) the deeming provisions (subsections 80G(6) and (12)); and

(iii) the principles of contract law.

Meaning of 'agreement' and subsections 80G(7), (15) and (16)

48. In the context of section 80G an agreement is formed by the parties deciding the amount of the loss of the loss company, the net assessable income of the income company, the amount of loss to be transferred, and making the necessary documentation for its transfer.

Alternative view

49. It could be argued that, where the loss of the loss company or the net assessable income of the income company are subsequently varied, the companies cannot be said to have reached an agreement in respect of a particular year of income. This is because the purported agreement has been made on the basis of an incorrect assumption of fact.

50. The Commissioner no longer accepts this view because the amending provisions in subsections 80G(7), (15) and (16) indicate that a valid agreement can be made on the basis of an amount of loss or net assessable income that is subsequently determined to be incorrect. These provisions have the effect of altering the amount of loss deduction which is effectively transferred under an agreement where there are changed circumstances in the loss company or in the income company. In addition, the provisions operate on the basis that there is no general authority to revoke the transfer document. These amending provisions are inconsistent with the view that there is no agreement at all when the amounts of loss or net assessable income have varied.

51. Subsection 80G(15) operates on the premise that the transfer document is valid only to the extent of the loss incurred by the loss company. Where there is a purported transfer of a loss deduction, and the whole or part of the loss was not deemed to have been incurred by the loss company, subsection 80G(15) empowers the Commissioner to disallow the deduction for the whole or part, as the case may be, of the deduction claimed by the income company. This is notwithstanding any provisions in section 170 of the Act which might otherwise have restricted the Commissioner's power to issue an amended assessment -

see also the decision in *Woolcombers v. FC of T* 95 ATC 4393; (1995) 31 ATR 39 (*Woolcombers'* case).

52. Pursuant to subsection 80G(7), where a loss company purports to transfer a loss deduction, the transfer document has no effect to the extent that the amount specified in the transfer document exceeds the net assessable income of the income company. Where other loss deduction amounts have been previously transferred to the income company, the sum of these transfers also must be taken into account in determining this excess. Furthermore, subsection 80G(16) supports the restriction in subsection 80G(7) by treating the transfer document as if it had only specified that part of the loss which is deductible to the income company. The loss company would therefore retain the loss deduction for the excess amount.

Subsections 80G(6) and 80G(12)

53. Pursuant to subsection 80G(6), the amount of the loss, or part of the loss, transferred is deemed to be the loss of the income company for the purposes of the provisions of the Act (other than section 80G). Conversely, the loss is deemed not to have been incurred by the loss company (subsection 80G(12)).

54. The deeming, in respect of both the income company and the loss company, is effective at the time that the provisions of subsections 80G(6) and (6A) have been satisfied (i.e., at the time the income company and the loss company agree in writing, signed by the public officers, that the right to the loss deduction is to be transferred). Therefore, as from that date the loss can no longer be dealt with by the loss company.

Principles of contract law

55. The Commissioner does not accept the view that contract law governs the validity of an agreement. Even if the agreement made under paragraph 80G(6)(c) was considered to be a binding contract at law, contract law would be of no assistance in claiming a revocation of such an agreement.

56. **Rescission** is not available (except in cases of fraud) where performance of the mutual obligations has been completed and the contract is no longer executory. Agreements under paragraph 80G(6)(c) are no longer executory at the moment they are made since the agreement immediately transfers the loss and deems it to be incurred by the income company. Consequently, there are no further obligations to be performed by the parties.

57. The income company and loss company would not be able to release each other from the performance of the agreement by way of a **discharge by agreement**. Under contract law, discharge pertains to the performance of further obligations under the contract. As there would be no further obligations, a new agreement would be required to purport to transfer back any losses which had been effectively transferred. However, under section 80G the loss is deemed to be incurred by the income company once a valid agreement has been made and there is no provision for an income company to 're-transfer' a loss deduction that it has received by way of a section 80G transfer.

Specificity

58. The Commissioner accepts that there is a level of flexibility inherent in the phrase 'whole or part of the loss' as it appears in paragraph 80G(6)(c). However, the use of the words 'amount specified' in a number of subsections within section 80G, in reference to the content of transfer documents, clarifies that the amount of loss deduction transferred has to be particularised. As such, formula documents capable of multiple applications as circumstances change are not acceptable. A formula document which states: 'Company A transfers sufficient of its losses to the extent of Company B's income' lacks the requisite certainty for a transfer document. However, upon execution, a formula document generally results in an amount specified equivalent to the amount of loss claimed as a deduction in the income tax return of the income company. In these circumstances the Commissioner will accept a formula document as being valid to transfer that amount only.

59. In examining transfer documents, at least three formats have been identified:

(i) sum specific, e.g., Company A transfers $100 to Company B;

(ii) sum expressed as percentage of loss in the loss company, e.g., Company A transfers to Company B 20% of the loss incurred in year X; and

(iii) sum expressed as a formula, e.g., Company A transfers to Company B an amount sufficient to cover the net assessable income less the sum of amounts which give rise to rebates/credits (e.g., dividends and foreign income).

60. Most transfer documents are in the form of (i) or (iii). Both percentage and formula modes (those in the form of (ii) or (iii)) come within the term 'formula document' as defined in paragraph 4 of this Ruling.

61. An interpretation giving formula documents unlimited life is not supported by legislation. This is because the tax law is predicated upon the application of the law to the facts as they are understood at a point in time. Generally, the Commissioner applies the law on an annual basis and assesses income at 30 June each year. Therefore, there must be certainty on an annual basis. This contrasts with the uncertainty of formula documents. This process of applying the law on an annual basis generally results in the issue of an assessment - see Kitto J in *Batagol v. FC of T* (1963) 109 CLR 243 at 252; 13 ATD 202 at 204.

62. Section 80G relies on the definitive determination of the 'loss' and the 'taxable income' at a point in time. The application of this principle in section 80G can be shown in paragraphs 80G(6)(a) and (b). Paragraph 80G(6)(a) requires the loss company to have incurred a loss. That loss is determined **specifically** as the excess of allowable deductions over the sum of assessable income and net exempt income. At any particular time this is an ascertainable amount. Paragraph 80G(6)(b) requires the income company to ascertain its 'taxable income' but for the operation of section 80G. Taxable income is determined **specifically** in terms of section 48.

63. In the *Woolcombers*' case, Branson J considered the application of subsection 80G(15) and section 170 in circumstances where the loss purportedly transferred had not in fact been incurred by the loss company. It is considered that her Honour correctly stated the view that the operation of section 80G is predicated upon the ascertainment, at a point in time, of amounts of income and loss. At ATC 4398; ATR 45 her Honour states:

> 'Plainly a loss was deemed for the purposes of section 80 of the Act to have been incurred by GHMA (the loss company) in the 1985 year. The effective operation of section 80 of the Act requires that losses are able to be identified in reference to a year in which they may be treated as having been incurred (see in particular s80(2)). The effective operation of section 80G(6) similarly requires that a loss can be identified with an income year. Section 80(1) effects the identification of a tax loss with a particular income year, and further provides how such loss is to be calculated. Section 80G(6)(a) expressly picks up the provisions of section 80(1).'

Alternative views

64. The alternative views are:

(i) that the references in section 80G to the 'loss' and to 'taxable income' are references to the final determination of those amounts; or

(ii) that a formula is effective to transfer a loss deduction since it estimates the amount of loss. (This reasoning follows section 51(1) of the Act, where a reasonable estimate of a presently existing liability may be deductible in certain circumstances.)

65. These views are not supported by the Commissioner because they preclude the proper operation of the deeming provisions in section 80G. The deeming sections (see paragraph 85 below) are necessary to transfer an entitlement to a loss deduction from the loss company to the income company. The process of deeming is dependent on an amount of loss being ascertained at a point in time. If the amount of income and loss is not finally ascertained until some later time (say, the making of a High Court decision), then no deeming could take place until that time. This would mean that section 80G would not take effect to transfer a loss deduction until that later time and tax would be payable by the income company in respect of the income year. Delaying the relief could adversely affect cash flows of the company group. Furthermore, the delay could result in the income company having an assessment for the income year which it would not otherwise have had.

66. In circumstances where the estimated loss deduction is not determined to be a specified amount for some years, section 170 may preclude an amended assessment to allow a deduction for the amount of loss. Interpreting section 80G so as to provide tax relief to the income company in the income year requires a transfer document to specify an agreed dollar amount of loss deduction. This specified amount of loss deduction is then the amount of deduction allowable to the income company under subsection 80G(6), subject to the variations provided for in subsections 80G(7), (15) and (16).

Recognition of changed circumstances within section 80G

67. It is recognised that the amounts of loss and net assessable income may change in circumstances where the facts or law are clarified. In this regard, section 170 specifically provides for amendments to assessments within four years. Section 80G also recognises that circumstances may change. As mentioned previously, subsections 80G(7) and (16) cover the situation where the loss purportedly transferred was greater than the net assessable income of the income company. In addition, the effect of subsection 80G(15) is that the loss company cannot transfer more than the total of its loss.

The fact that changed circumstances are specifically provided for in the legislation further supports the Commissioner's view that the open-ended operation of formula documents would be contrary to the certainty required for the operation of section 80G.

'Part of the loss'

68. The Commissioner acknowledges the flexibility of the phrase 'whole or part of the loss' as it appears in paragraph 80G(6)(c). It enables the whole or a fraction of a loss to be transferred. However, this does not mean uncertainty because 'loss' in section 80G refers to a 'loss' as calculated under the loss provisions (see definition at paragraph 4 above). This is determined as a specific sum. 'Part' has its ordinary meaning and is defined in the *Macquarie Dictionary* to mean a portion, a division and not the whole. When the phrase 'part of a loss' is considered, it means a portion of the total loss as determined pursuant to a loss provision (say, under section 79E) and it must refer to a specific sum. Indeed, when the income company claims the loss transferred to it as a deduction, it will claim a specific sum in its return of income.

'Amount specified'

69. In those provisions of section 80G which refer to the **content** of a transfer document, there is a consistent use of the term 'amount specified'. In particular, subsections 80G(7), (8), (13), and (16) all operate on the premise that a specific amount is stated in the agreement. It is therefore considered that the loss deduction, which the loss company and the income company have agreed to transfer, must be specified in the transfer document.

70. The definitions of the words 'amount specified' support the view that formula documents are not acceptable for section 80G. In the *Macquarie Dictionary* the term 'amount' refers to quantity, and 'specified' means to mention or name specifically or definitely, to state in detail, to give specific character to, or to make specific mention or statement.

71. 'Amount specified' may, therefore, be said to be a fixed or definite quantity. These words do not exclude the possibility of arriving at a fixed amount by means of a formula document. However, the 'amount specified' refers to the fixed or definite quantity of the **loss** which creates the certainty requisite in section 80G. This imputes a particularity not present in a formula document which may operate to vary the relevant amount of loss deduction from time to time as circumstances change.

72. Case law supports this interpretation of the words 'amount specified'. In *TCN Channel Nine Pty Ltd & Others v. AMP Society* (1982) 42 ALR 496; 62 FLR 366 (*TCN* case), the Full Federal Court considered the meaning of the phrase 'amounting to a specified amount' and the word 'specified'. It was held that 'specified' meant 'stating in particularity or detail'. In *Federated Engine Drivers v. BHP Co Ltd* (1911) 12 CLR 600, the High Court looked at a conciliation and arbitration matter and, in that context, defined the word 'specified' to mean 'naming expressly' or 'stating in full and explicit terms'.

73. In the *TCN* case, when considering the amount of control exercised by the owners of television stations, the Court held that the phrase 'amounting to a specified amount' was capable of expression in percentage terms. The relevant legislation reviewed in that case used percentage terms to measure the level of share holding. However, the Full Federal Court held that a percentage certificate of ownership could not be based on hypothesis or conjecture. The Court held that the Australian Broadcasting Tribunal must have regard to a clearly identified transaction. Although in a different legislative context, this case supports the principle that formula documents could only satisfy the **specificity** required under section 80G in circumstances where they purport to transfer a defined percentage of a loss amount. The percentage would apply to the amount of loss determined at the time of making the agreement, that is, a specified sum. The result would be a determined dollar amount.

74. In the alternative, it could be argued that the definition in the *TCN* case, allowing the use of *percentum* formula documents, is distinguishable in the context of section 80G because that case referred to legislation governing the ownership of broadcasting licences. In that context, the percentage of share holding is a material measure of ownership. In section 80G, the appropriate measure of a loss, or part thereof, is a specific dollar sum. As such, it is the Commissioner's view that 'amount specified' in section 80G must refer to a particularised amount, and cannot refer to an amount which is capable of change (other than as provided for in section 80G - see paragraph 67 above).

Subsection 80G(6A)

75. Subsection 80G(6A) sets out the requirements of an agreement - that it must be in writing and signed by the relevant Public Officers. While not stating expressly, it **imputes** a process of identification of specific sums:

(i) the **net assessable income** of the income company but for section 80G;

(ii) the amount of **loss** available; and

(iii) the amount of the loss deduction to be **transferred**.

76. This imputed identification process comes from understanding subsection 80G(6A) in its context (see particularly the identification of taxable income in paragraph 80G(6)(b)) and from the former paragraph 80G(6)(c).

77. When subsection 80G(6A) was introduced, the new provision was not intended to alter the former provision except to facilitate self-assessment changes, e.g., notices were no longer required to be lodged with the Commissioner. Therefore, the understanding of the former provision (paragraph 80G(6)(c)) assists in understanding the present subsection 80G(6A).

'Specified part'

78. The phrase within the former paragraph 80G(6)(c) '...so much of the whole or a **specified part** of the loss', indicates that fractions of the loss can be transferred. As previously mentioned, the loss is a set sum, determined at a point in time, pursuant to the loss provisions. Therefore, a part of the loss ('so much of') is also a defined quantity.

79. The requirement of a definite sum in a loss transfer document comes from the reference to a 'specified part' of the loss. As previously mentioned, 'specified' means 'defined'. 'Specified' in its ordinary meaning requires particularity that is not found in a formula document and which is capable of multiple applications as circumstances change. 'Part' is defined as a proportion; something less than the total. Taken together, the adjectival phrase 'specified part' imputes certainty in a transfer document, i.e., it could be read as saying 'the proportion of the loss which is defined'.

Explanatory Memorandum

80. The argument that section 80G requires specificity is also supported in the Explanatory Memorandum to *Income Tax Assessment Amendment Bill (No 4) 1984* which introduced section 80G. The Explanatory Memorandum states at 31:

> 'As part of the formal mechanism for transfer, the public officers of the respective companies will be required to give written notice to the Commissioner of Taxation **specifying details of the loss or losses which are to be transferred**.' (emphasis added)

Complying with subsection 80G(13)

81. A further complexity would arise if a formula document had unlimited life. It would prevent the loss company from making further transfers because it would not be able to satisfy subsection 80G(13). This result is clearly against the policy of section 80G which is intended to facilitate the transfer of losses within company groups.

82. As previously mentioned, subsection 80G(13) provides that a loss company can only enter into further transfer documents in respect of the balance of loss remaining after subtracting from its total loss the sum of the amounts specified in any previous loss transfer documents. It recognises that a loss can be transferred over many years and to a variety of group companies. As a consequence, transfers of fractions of the total loss are acceptable so long as the sum of the amounts transferred does not exceed the total amount of the loss.

83. If the amount in the agreement fluctuates, for example depending upon the net assessable income of the income company, the actual amount of the loss transferred cannot definitively be ascertained until such time as either both the Commissioner and the income company agree as to its net assessable income or a court finally determines the true net assessable income. In such circumstances, the balance of the loss available to the loss company is unclear.

84. The question of whether subsection 80G(13) is complied with must be determined prior to the time that the loss company purports to enter into further agreements. If at this time, the amount of the loss transferred is not certain, it follows that subsection 80G(13) would preclude the loss company from entering into further agreements.

Deeming under subsections 80G(6) and 80G(12)

85. The view that transfers of losses must be of specific sums is also supported by the deeming provisions of subsections 80G(6) and 80G(12). Subsection 80G(6) states that the amount of loss or part of the loss transferred is deemed to be a loss of the income company. Subsection 80G(12) is the corollary of subsection 80G(6), and states that where the loss or part of the loss is transferred to the income company, that loss or part of the loss will be deemed not to be incurred by the loss company. These deeming provisions are predicated upon:

(i) the loss being a determined amount, at a point in time;

(ii) the agreement effecting a **transfer** of the loss deduction or a determined amount thereof; and

(iii) the amount so transferred is no longer a loss deduction of the loss company, and will be a loss deduction of the

income company, i.e., there must be an identified, ascertained amount.

86. If a loss deduction resulting from the use of a formula document could change as circumstances of the loss company and income company change, there could not be sufficient specificity to allow deeming to operate effectively.

87. Where the amount of the loss deduction agreed to be transferred is incapable of being accurately determined in the income year, subsection 80G(6) would not operate to deem the loss to have been incurred by the income company in that income year. As a consequence, a deduction is not available to the income company in respect of the loss deduction.

88. This follows from the words of subsection 80G(6) that do not permit an **estimated** amount of loss:

> '...the amount of the loss or that part of the loss...shall...be deemed to be a loss incurred by the income company for the purposes of section 79E...'

89. Therefore, formula documents which initially could only **estimate** the amount of loss deduction agreed to be transferred, would not allow a deduction to the income company.

Finality

90. It is considered that if formula documents are accepted, then a difficulty could arise in that finality could rarely be obtained.

91. For example, if a transfer document purported to transfer 20% of a loss, and the loss subsequently increased from $100 to $200, on one view, the amount of the loss deduction transferred would be automatically increased by $20. This might not create a difficulty if the loss transferred exceeded the net assessable income of the income company. In those circumstances, subsections 80G(7) and 80G(16) could combine so that:

(i) the loss deduction transferred is limited to the extent of the net assessable income in the income company; and

(ii) the loss company retains the excess loss.

92. However, a problem could arise if the income company had sufficient net assessable income to absorb the extra $20 loss deduction. As mentioned above (see paragraph 66), no amendment could be effected outside the period provided for in section 170.

Revocation

93. The unlimited operation of formula documents is also rejected because this would permit, in effect, a revocation of subsequent agreements. If there was an increase in the income of the income company, on one view, the formula document would have the effect of increasing the amount of the loss transferred into the income company. If the loss company had used up all its losses (e.g., by self-recoupment or transferring out to other entities), then the formula document could only work if losses were clawed back from other years or other entities.

94. Section 80G does not authorise the revocation of effective loss transfers (see paragraph 47 above). A transfer document cannot be withdrawn. However, subsections 80G(15) and (16) operate to amend the amount specified in the agreement (subsection 80G(16)) or to reduce the deduction available to the income company (subsection 80G(15)). In each case, the transfer document remains valid to the extent provided.

Alternative view

95. It could be argued that formula documents operate into the future and have the effect of overriding any subsequent agreements to the extent that the amount of the loss required to satisfy the formula in a later year exceeds the amount transferred in the year in which the formula document has first applied. Such an operation of a formula document clearly effects a revocation of any subsequent valid agreement and is inconsistent with the general principle of irrevocability.

Exercise of the discretion under subsection 80G(6A)

96. Paragraph 80G(6A)(b) provides that an agreement under paragraph 80G(6)(c) must be:

> 'made before the date of lodgment of the return of income of the income company for the income year **or within such further time as the Commissioner allows**.' (emphasis added)

97. This part of the Ruling provides a general guide for taxpayers and officers of the ATO when considering the exercise of this discretion. This is desirable in the interests of consistent, efficient administration and equity among taxpayers in similar circumstances. However, the decision-maker must exercise a discretion according to the merits of each case and should not fetter a discretion by inflexibly applying or acting in blind obedience to a policy or rule (see *R v.*

Moore; Ex parte Australian Telephone and Phonogram Officers Association (1982) 148 CLR 600).

Factors relevant to the exercise of the discretion

98. The exercise of the discretion under subsection 80G(6A) will involve a two-step process of identifying relevant factors and applying a weighting to each of those factors having regard to the circumstances of the case. Further, it is for the decision-maker to determine the appropriate weighting to be applied to these factors - see *Minister for Aboriginal Affairs v. Peko-Wallsend Ltd* (1986) 162 CLR 24.

99. Applications for the exercise of the discretion will usually fall into one of two broad categories. The first is where it can be said that there has been delay on the part of the taxpayer which results in non-compliance with the subsection 80G(6A) time limit. The second is where the request for an extension of time to make an agreement arises out of an adjustment to the tax position of the company group by the Commissioner. The following paragraphs outline the factors which the Commissioner considers to be relevant to the exercise of the discretion under subsection 80G(6A) in both categories of case, although they are by no means exhaustive.

Non-compliance with time limit caused by delay of the taxpayer

100. This category encompasses cases where no agreement has been made prior to the date of lodgment of the income company's return or, where an agreement has been made, the group subsequently discovers, for example, that:

(i) there are further losses within the group available for transfer to the income company; or

(ii) the income company has additional income against which unused losses within the group can be offset.

101. In these cases the Commissioner considers that the principles outlined by Wilcox J in *Hunter Valley Developments* in respect of statutory discretions to extend time will be relevant to the subsection 80G(6A) discretion, albeit that the case was decided in the context of a different statutory provision. The Commissioner also considers that these general principles need to be balanced with a consideration of the underlying policy of section 80G (to align broadly the treatment of company groups with divisional companies) and the wider consideration of the proper administration of the Act.

102. In *Hunter Valley Developments*, Wilcox J stated that statutory time limits are not to be ignored and that the onus is on the applicant

to convince the decision-maker that the case is an appropriate one for a favourable exercise of the discretion. This would generally require the taxpayer to provide an acceptable explanation of the delay. In *Case 36/94* 94 ATC 327; *AAT Case 9568* (1994) 29 ATR 1001 (*Case 36/94*), the Tribunal considered at ATC 332; ATR 1007 that this would:

> '...require the applicant to convince the decision-maker that there are unusual circumstances and that the failure was not due only to inadvertence.'

103. Accordingly, where the delay in completing loss transfer documents occurs as a result of unusual circumstances, as opposed to mere inadvertence in the preparation of returns, then it will be more likely that the explanation will be considered by the Commissioner to be acceptable and the discretion exercised favourably - see also *Case 15/96* 96 ATC 220; *AAT Case 10688* (1996) 31 ATR 1315. The length of the delay in making an agreement after the prescribed time will also be relevant to the exercise of the discretion. Generally, the longer the delay, the greater the onus is upon the applicant to demonstrate an acceptable explanation for the delay (see *Stergis and Ors v. Boucher and Ors* (1989) 86 ALR 174).

104. The Commissioner will weigh the explanation of delay with the other relevant factors referred to in *Hunter Valley Developments* (for example, public interest considerations and the question of prejudice to either party arising from the exercise or non-exercise of the discretion).

Extension of time requests arising from ATO adjustments

105. In this category of case, there generally would have been compliance with the requirement to enter into loss transfer agreements within the time stipulated in subsection 80G(6A). However, as a result of an adjustment to the taxation position of the group by the Commissioner there is a request for an extension of time to enter into a further agreement or further agreements.

106. In *Bond Corporation Holdings Ltd v. Australian Broadcasting Tribunal* (1988) 84 ALR 669, Gummow J stated that the range of factors which can be considered in the exercise of an unfettered discretion (such as that contained in subsection 80G(6A)) is unconfined, subject to any implied limitation within the relevant legislation. It is considered that there is nothing within the subject matter, scope and purpose of section 80G (or the rest of the taxation legislation) which would imply any limitation upon the Commissioner to consider the conduct of a company group giving rise to an adjustment as being a relevant factor to the exercise of the discretion.

In fact, this is in line with the principle of self-assessment under the Act and the onus on the taxpayer to comply with its obligations under the law.

107. Accordingly, where an adjustment is made as a result of fraud or evasion on the part of the company group, or there is a scheme to which Part IVA applies, then these factors will generally weigh heavily against a favourable exercise of the discretion. If the adjustment results from a failure to take a reasonably arguable position or from reckless behaviour, then these factors will be similarly relevant. In a sense it could be said that in these circumstances the delay was directly attributable to the actions of the taxpayer. Conversely, in cases where it cannot be said that the conduct of the group is culpable in respect of its failure to comply with its obligations under the law, this will be a factor which will weigh in favour of an extension of time being granted.

Taxation Ruling IT 2624

108. It has been suggested that paragraphs 20 to 22 of Taxation Ruling IT 2624 require that in every case the discretion should be exercised in the taxpayer's favour. The purpose behind IT 2624 was to facilitate the introduction of self-assessment and to reduce the amount of information that taxpayers had to supply in their returns. From 1 July 1992, the law was changed such that taxpayers no longer are required to lodge notices, but must enter into agreements. As such, IT 2624 has no application to agreements entered into under subsection 80G(6A).

Examples

Effect of changed circumstances on subsection 80G(6) agreements

109. It is possible to outline five broad examples under which changed circumstances of group companies may affect the validity of transfer documents and/or cause group companies to seek to enter into transfer documents out of time. The following provides a guideline as to the operation of the law in each case. The five examples are:

(i) Insufficient loss example;

(ii) Insufficient income example;

(iii) Increased loss example;

(iv) Increased income example; and

(v) No original transfer document example.

(i) Insufficient loss example

110. This will occur where, for any reason, the loss of the loss company is less than originally determined (e.g., through an error in the return or audit action) so that there are consequently insufficient losses for transfer to the income company.

(a) The simplest case is where there is one transfer document between a loss company and an income company, e.g., a loss company transfers a loss of $20 to an income company with a net assessable income of $100. As a result of an audit, the losses of the loss company available for transfer are reduced to $10. The operation of subsection 80G(15) enables the Commissioner to disallow that part of the loss which was not deemed to have been incurred by the loss company and to amend the assessment of the income company accordingly. Therefore, the transfer document remains valid to the extent of the $10 which was capable of being transferred.

(b) The more complex example is where the loss company has made multiple transfer documents with different companies, e.g., available losses of $20, and transfer documents entered into with four companies to transfer $5 to each. As a result of an audit, available losses are reduced to $16. The Commissioner's view is that the first three transfer documents in time are still valid. In some cases, this will be easy to ascertain, particularly where the transfer documents are made on different days. In other cases, the Commissioner may be guided by the taxpayer as to which transfer documents were made first. The last transfer document in time is valid to the extent of $1.

(ii) Insufficient income example

111. In this case, an amendment to the income company reduces its net assessable income to a level so that it is unable to absorb the amount of loss specified in the transfer document, e.g., a loss company transfers $20 to an income company with a net assessable income of $20. An audit amendment to the income company's return reduces its taxable income to $10. Subsection 80G(7) operates and provides that an agreement has no effect to the extent that it purports to transfer a loss amount from a loss company which exceeds the net assessable income of the income company.

112. In these circumstances, subsection 80G(16) operates to treat the transfer document as if it had specified the amount which the income

company is capable of absorbing ($10) and enables the loss company to retain the remaining $10. The loss company may then seek a favourable exercise of the Commissioner's discretion under subsection 80G(6A) to make a further agreement to transfer the excess loss ($10) to another company. The same principles in respect of validity and transfer documents made first in time, as outlined in scenario (b) of the Insufficient loss example, apply where there are multiple loss companies transferring losses to the income company with the reduced net assessable income.

(iii) Increased loss example

113. In this instance, the loss company has made transfer documents and, subsequently, it is discovered that the amount of loss available for transfer is greater than initially determined (e.g., through an error in preparing a return). This includes an example where the loss company wishes to transfer further losses to a company with which it has already made a loss transfer agreement. Subsection 80G(13) anticipates that a loss company can make more than one transfer document under subsection 80G(6), by providing that the sum of the losses which have been transferred by the loss company under multiple transfers must not exceed the total amount of the loss incurred by the company. There is nothing within this subsection or the other provisions of section 80G to indicate that the making of further transfer documents to transfer losses should be limited to companies with which the loss company has not made any previous agreement. In this case, it may be a matter for the Commissioner's discretion as to whether further time should be allowed to make the additional agreement(s).

(iv) Increased income example

114. In this example, a transfer document has been entered into and, subsequently, the net assessable income of the income company is increased. As a result, the income company wishes to make a further agreement or further agreements to transfer losses from either the loss company or another company with losses within the group. The loss deduction transfer may only take place where the loss company has losses available in respect of the year in which the income company has increased net assessable income. The loss company **cannot revoke** any subsequent loss deduction transfers it has made with other group companies and transfer those losses to the income company. Where the loss company has losses available, the question of whether the losses can be transferred to the income company is subject to the exercise of the Commissioner's discretion under subsection 80G(6A).

(v) No original transfer document example

115. This is the case where there has been no loss transfer document entered into by the date of lodgment of the income company return and there is simply a request for the Commissioner to exercise the discretion under subsection 80G(6A) to allow the making of the agreement out of time (see discussion at paragraph 96 above on this exercise of the Commissioner's discretion). In circumstances of the appropriate lodgment of returns, the Commissioner would generally exercise his discretion if the transfer document is signed on the date that the return of the income company is lodged.

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Your comments

117. If you wish to comment on this Draft Ruling, please send your comments by: 31 May 1996

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