


TD 2005/D45 - Income tax: consolidation: losses: when a company that joins an existing MEC group is an eligible tier-1 company, do prior group losses of the head company of that group become subject to the loss utilisation rules in Subdivision 707-C of the Income Tax Assessment Act 1997 ?

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This document has been finalised by TD 2006/50.



Draft Taxation Determination

Income tax: consolidation: losses: when a company that joins an existing MEC group is an eligible tier-1 company, do prior group losses of the head company of that group become subject to the loss utilisation rules in Subdivision 707-C of the *Income Tax Assessment Act 1997*?

Preamble

*This document is a draft for industry and professional comment. As such, it represents the preliminary, though considered views of the Australian Taxation Office. This draft may not be relied on by taxpayers and practitioners as it is not a ruling for the purposes of Part IVAAA of the **Taxation Administration Act 1953**. It is only final Taxation Determinations that represent authoritative statements by the Australian Taxation Office.*

1. Yes. When such a company becomes a member of the MEC (multiple entry consolidated) group, Subdivision 707-C of the *Income Tax Assessment Act 1997* (ITAA 1997) will apply to prior group losses of the head company so that their utilisation will be limited by reference to an available fraction.

Note: This draft Taxation Determination:

- does not apply if the company was a subsidiary member of the MEC group immediately before it becomes an eligible tier-1 company of the top company; and
- applies whether or not the company has any losses when it becomes an eligible tier-1 company.

Explanation

2. When a company that joins an existing MEC group is an eligible tier-1 company, an application event happens (subsection 719-300(2) of the ITAA 1997). At the time of the application event, all prior group losses are taken to have been transferred by the head company to itself under Subdivision 707-A of the ITAA 1997 for the purpose of the utilisation of those losses under Subdivision 707-C of the ITAA 1997 (subsection 719-305(2) of the ITAA 1997).

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Note: The prior group losses are treated as having been transferred to the head company under Subdivision 707-A of the ITAA 1997 without needing to consider the transfer tests in that Subdivision.

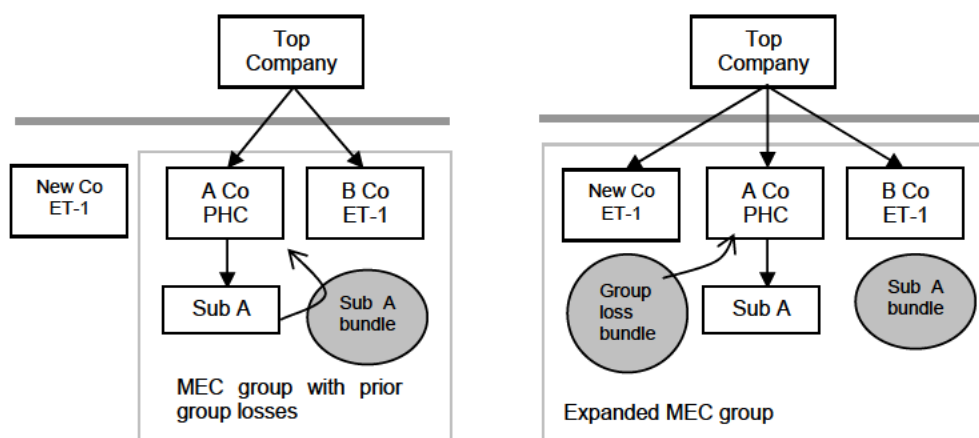
3. Prior group losses are all losses of any sort that the head company has made for income years ending before the application event. These losses do not include any losses transferred to the head company under Subdivision 707-A of the ITAA 1997.

4. Subdivision 707-C of the ITAA 1997 contains rules about the utilisation of transferred losses in a particular bundle of losses. The utilisation of these transferred losses is limited by reference to an available fraction for the bundle (subsection 707-310(1) of the ITAA 1997). Subdivision 707-C has effect in relation to a MEC group in the same way it has effect in relation to a consolidated group, subject to any of the modifications set out in Division 719 of the ITAA 1997 (for example, section 719-305 of the ITAA 1997).¹

5. Prior group losses are treated as being in a bundle of losses and an available fraction is worked out for that bundle under subsection 707-320(1) of the ITAA 1997.

6. The available fraction worked out for the prior group losses bundle will determine what proportion of the group's income or gains can be offset against prior group losses. Restricting the use of prior group losses broadly ensures that they are only offset against the portion of the group's income and gains that relates to those entities that contributed to the making of those losses. This means that prior group losses are used at approximately the same rate that would have occurred had the application event not happened.

7. For the purpose of working out the available fraction for the prior group losses bundle, the modified market value of the head company (subsection 707-325(1) of the ITAA 1997) is worked out as though the MEC group is a single entity. Each subsidiary member of the group that existed prior to the application event is treated as being part of the head company (subsection 719-305(3) of the ITAA 1997). This ensures that the integrity rule in subsection 707-325(2) of the ITAA 1997 has application in working out the head company's modified market value. The integrity rule will have effect if the group's modified market value has increased as a result of any injections of capital into the group or non-arm's length transactions involving members of the group in the four years before the application date.

Example

¹ Section 719-2 of the ITAA 1997.

8. A Co and B Co are eligible tier-1 companies of Top Company. Sub A is a wholly owned subsidiary of A Co. On 1 July 2003, A Co, B Co and Sub A form a MEC group with A Co as the provisional head company (PHC). At the end of the 2004 income year A Co becomes the head company for that year.

9. At the time of formation, losses are transferred under Subdivision 707-A of the ITAA 1997 to A Co from Sub A (the Sub A bundle) for which an available fraction is worked out under subsection 707-320(1) of the ITAA 1997. A Co as the head company of the MEC group, makes a loss (group loss) in the 2004 income year.

10. On 1 July 2004, New Co is acquired and becomes an eligible tier-1 company of Top Company. A Co, as the PHC, informs the Commissioner that New Co will become a member of the MEC group (subsection 719-5(4) of the ITAA 1997). New Co has no losses when it joins the MEC group (the application event).

11. Section 719-305 of the ITAA 1997 applies as a result of New Co becoming a member of the MEC group (subsection 719-300(2) of the ITAA 1997). This section provides that the group loss is taken to have been transferred under Subdivision 707-A of the ITAA 1997 to the head company of the MEC group. Subdivision 707-C of the ITAA 1997 then applies in relation to the utilisation of the group loss and an available fraction must be worked out for the group loss bundle.

12. Another result of New Co becoming a member of the MEC group is that the available fraction of the Sub A bundle is reduced or maintained under subsection 719-310(2) of the ITAA 1997 to reflect any changes in the market value of the group due to New Co joining the group. Also, section 719-315 of the ITAA 1997 must be applied to determine whether the available fractions for the Sub A bundle and the group loss bundle are further reduced.

Date of Effect

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

Your comments

14. We invite you to comment on this draft Taxation Determination. Please forward your comments to the contact officer by the due date.

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Commissioner of Taxation

12 October 2005

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 92/20

Subject references:

- application event
- available fraction
- bundle of losses
- consolidation
- eligible tier-1 company
- head company
- joining entity
- losses
- MEC group
- modified market value
- new eligible tier-1 company
- prior group losses
- subsidiary member

- transfer tests
- transferred losses

Legislative references:

- TAA 1953 Pt IVAAA
- ITAA 1997 Subdiv 707-A
- ITAA 1997 Subdiv 707-C
- ITAA 1997 707-310(1)
- ITAA 1997 707-320(1)
- ITAA 1997 707-325(1)
- ITAA 1997 707-325(2)
- ITAA 1997 Div 719
- ITAA 1997 719-2
- ITAA 1997 719-5(4)
- ITAA 1997 719-300(2)
- ITAA 1997 719-305
- ITAA 1997 719-305(2)
- ITAA 1997 719-305(3)
- ITAA 1997 719-310(2)
- ITAA 1997 719-315

ATO references

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