


TD 2006/D37 - Income tax: consolidation: can the transfer of a tax loss under section 707-120 of the Income Tax Assessment Act 1997, to the extent that it could have been utilised by the transferor in the trial year under section 165-20 of that Act, constitute a COT transfer?

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This document has been finalised by TD 2006/75.



Draft Taxation Determination

Income tax: consolidation: can the transfer of a tax loss under section 707-120 of the *Income Tax Assessment Act 1997*, to the extent that it could have been utilised by the transferor in the trial year under section 165-20 of that Act, constitute a COT transfer?

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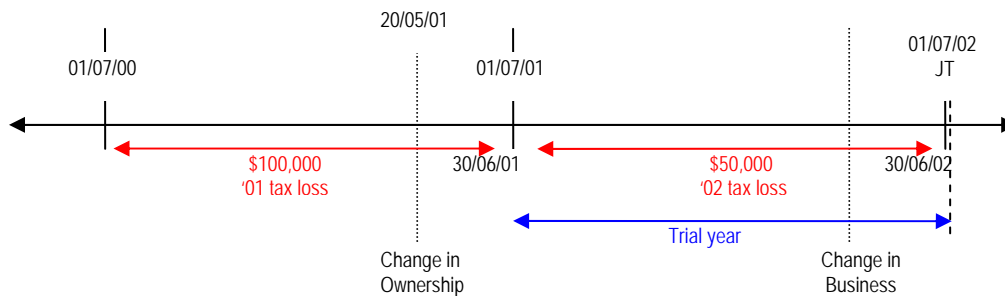
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Ruling

1. No. The transfer of the tax loss to the head company cannot be a COT transfer as defined in subsection 707-210(1A) of the *Income Tax Assessment Act 1997* (ITAA 1997) as the transferor is unable to meet the conditions in section 165-12 of the ITAA 1997 in respect of the loss. The tax loss is transferred because the transferor meets the conditions in section 165-20 of the ITAA 1997.

Example

2. *Sub Co joins a consolidated group on 1 July 2002, the time the group comes into existence (JT). Prior year tax losses of Sub Co are tested to determine whether they are transferred to the head company. Sub Co's income year ended on 30 June.*
3. *Sub Co experienced a majority change in ownership on 20 May 2001. The business of Sub Co changed in the trial year.*



4. Each tax loss must be tested to determine whether it is transferred to the head company. The 2001/2002 tax loss is transferred as Sub Co has maintained continuity of ownership from the beginning of the loss year through to the end of the trial year, that is, from 1 July 2001 to just after 1 July 2002.
5. The 2000/2001 tax loss fails the continuity of ownership test (COT) as a change in ownership occurred during the loss year. Sub Co also fails the same business test as the business was changed during the trial year. However, it is established that \$10,000 of the 2000/2001 tax loss was incurred after the change in ownership for the purpose of applying section 165-20 of the ITAA 1997. This amount of the tax loss could have been utilised in the trial year by Sub Co under section 165-20 on the assumptions in subsection 707-120(1) of the ITAA 1997.
6. Therefore \$10,000 of the 2000/2001 tax loss, being the extent to which the tax loss could have been utilised by Sub Co in the trial year on the relevant assumptions, is able to be transferred to the head company.
7. The transfer of the 2000/2001 tax loss cannot be considered a COT transfer for the purpose of section 707-210 of the ITAA 1997 as the tax loss was unable to satisfy the COT. The transfer occurred because \$10,000 of the loss could have been utilised in the trial year under section 165-20 of the ITAA 1997.

Date of effect

8. When the final Determination is issued, it is proposed to apply to years commencing 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.

Commissioner of Taxation

26 July 2006

Appendix 1 – Explanation

① *This Appendix is provided as information to help you understand how the Commissioner's preliminary view has been reached. It does not form part of the proposed binding public ruling.*

Explanation

9. A tax loss worked out under section 36-10 of the ITAA 1997¹ is the amount by which a taxpayer's allowable deductions exceed its total assessable income and net exempt income for an income year, which is called a loss year.

10. An income year is a 12 month period² that ends on 30 June, or another date if the taxpayer has adopted an alternative accounting period. It follows that a reference to a tax loss throughout the ITAA 1997 and the *Income Tax Assessment Act 1936* is a reference to a loss that was incurred for an income year.³

11. A tax loss may be available to be deducted from assessable income derived in a subsequent income year, that is, the tax loss is 'carried forward'. Section 165-10 of the ITAA 1997 provides that a company cannot deduct a tax loss unless either:

- it meets the conditions in section 165-12 of the ITAA 1997 (the continuity of ownership test); or
- it meets the condition in section 165-13 of the ITAA 1997 (the same business test).⁴

12. If section 165-10 of the ITAA 1997 prevents a company from deducting a tax loss, a deduction for part of the tax loss that was incurred during a part of the loss year may be available under section 165-20 of the ITAA 1997. Section 165-20 allows a company to deduct a part of the tax loss that was incurred in part of the loss year only if, assuming that part of the loss year had been treated as the whole of the loss year, the company would have been entitled to deduct the tax loss. That is, if section 165-10 can be satisfied by assuming part of the loss year was the whole loss year, the company can deduct that part of the tax loss incurred in that period.

13. Section 707-120 of the ITAA 1997 provides for the transfer of a tax loss from a joining entity to the head company of a consolidated group. A tax loss is transferred *to the extent* that the loss could have been utilised by the joining entity for an income year consisting of the trial year on certain assumptions⁵. The trial year⁶ is a hypothetical income year that generally starts 12 months before the joining time and ends just after the joining time. The general loss recoupment tests, as modified by the consolidation rules, are applied to the joining entity for the trial year to determine whether a loss is transferred to the head company.

¹ A tax loss can also be worked out under sections 165-70, 175-35 and 701-30 of the ITAA 1997. This Taxation Determination applies equally to tax losses worked out under those sections.

² Refer to subsections 4-10(2) and 9-5(2) of the ITAA 1997.

³ A tax loss can be made for a period shorter than 12 months. In this scenario the amount of the loss is deemed a loss for an income year. For an example refer to section 701-30 of the ITAA 1997.

⁴ A company cannot satisfy the same business test for the whole or part of the income year if the total income of the company exceeds \$100 million for the income year – section 165-212A of the ITAA 1997.

⁵ Subsection 707-120(1) of the ITAA 1997.

⁶ As defined in subsection 707-120(2) of the ITAA 1997.

14. The words 'to the extent' in subsection 707-120(1) of the ITAA 1997 provide for the transfer of the amount of the tax loss that could have been utilised under section 165-20 of the ITAA 1997 by the joining entity in the trial year.

15. The head company is taken to have made the loss, to the extent it is transferred, for the income year in which the transfer occurs.⁷ The subsequent utilisation of that transferred loss is affected by Subdivision 707-B of the ITAA 1997 which modifies the loss recoupment tests in determining whether a head company can utilise a transferred loss. The modifications depend on how the tax loss was transferred to the head company.

16. Rules contained in section 707-210 of the ITAA 1997 establish whether the 'latest transferee' can utilise a loss that it made because of a COT transfer. Subsection 707-210(1A) of the ITAA 1997 defines a COT transfer as follows:

- (1A) A transfer of a loss under Subdivision 707-A from a company to a company is a **COT transfer** of the loss if the transfer occurs because:
 - (a) the transferor meets the conditions in section 165-12; and
 - (b) the conditions in one or more of paragraphs 165-15(1)(a), (b) and (c) do not exist in relation to the transferor.

17. A transfer of a tax loss, to the extent of the amount that could have been utilised by the transferor in the trial year under section 165-20 of the ITAA 1997, cannot be a COT transfer. The words 'a loss' in subsection 707-210(1A) of the ITAA 1997 are a reference to the tax loss made for an income year. The requirement in paragraph 707-210(1A)(a) is that the transferor must meet the conditions in section 165-12 of the ITAA 1997 in respect of that tax loss. Where a tax loss is transferred to the extent of the amount that could have been utilised in the trial year under section 165-20, it follows that the conditions in subsection 707-210(1A) cannot be satisfied because the transferor would not meet the conditions in section 165-12 in respect of the tax loss.

18. While a deduction for part of the tax loss may ultimately rely on a re-examination of the conditions in section 165-12 of the ITAA 1997 in respect of part of the loss year, the tax loss is actually transferred because section 165-20 of the ITAA 1997 would provide a deduction in the trial year and not because the transferor met the conditions in section 165-12 in respect of the tax loss.

19. As the transfer of a tax loss by reason of the operation of section 165-20 of the ITAA 1997 cannot constitute a COT transfer, section 707-210 of the ITAA 1997 does not apply to the loss. Rather, section 707-205 of the ITAA 1997 operates to 'refresh' the loss year to start at the time of the transfer. This means that when testing the ownership of the head company to determine whether it can utilise the transferred tax loss, the ownership test period starts at the time of transfer.

⁷ Paragraph 707-140(1)(a) of the ITAA 1997.

Appendix 2 – Your comments

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

Due date: 25 August 2006

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TD 2006/D38

Subject references:

- consolidation - continuity of ownership test
- consolidation - losses
- COT transfer
- joining time
- tax loss
- transfer of losses
- transferred losses
- trial year
- unused carry forward losses
- utilise a loss
- year of income

- ITAA 1997 165-13
- ITAA 1997 165-15(1)(a)
- ITAA 1997 165-15(1)(b)
- ITAA 1997 165-15(1)(c)
- ITAA 1997 165-20
- ITAA 1997 165-70
- ITAA 1997 165-212A
- ITAA 1997 175-35
- ITAA 1997 701-30
- ITAA 1997 Subdiv 707-A
- ITAA 1997 707-120
- ITAA 1997 707-120(1)
- ITAA 1997 707-120(2)
- ITAA 1997 707-140(1)(a)
- ITAA 1997 Subdiv 707-B
- ITAA 1997 707-205
- ITAA 1997 707-210
- ITAA 1997 707-210(1A)
- ITAA 1997 707-210(1A)(a)

Legislative references:

- ITAA 1936
- ITAA 1997 4-10(2)
- ITAA 1997 9-5(2)
- ITAA 1997 36-10
- ITAA 1997 165-10
- ITAA 1997 165-12

Other references:

- Consolidation Reference Manual 'Transfer testing where control or ownership failure and a change in business within the trial year', C3-3-270

ATO references

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