


IT 2465 - Income tax : transfer of loss within a company group

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TAXATION RULING NO. IT 2465

INCOME TAX : TRANSFER OF LOSS WITHIN A COMPANY GROUP

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I 1010547 COMPANY GROUP LOSSES 80G

PREAMBLE

The purpose of this Ruling is to clarify the application of section 80G, inserted in the Income Tax Assessment Act 1936 ("the Assessment Act") by the Income Tax Assessment Amendment Act (No.4) 1984 (Act No.124 of 1984). Broadly, section 80G allows the right to an allowable deduction for a loss incurred by a resident company in the 1984-85 year of income or a subsequent year of income, to be transferred to another resident company, where at relevant times each company is a "group company" in relation to the other, i.e., there is 100% common ownership of the two companies, one being a "subsidiary", as defined, of the other or each being a "subsidiary" of the same company.

2. The Ruling should be read in conjunction with the general explanation of the legislation found at pages 6-7 and the more detailed explanation found at pages 29-40 of the explanatory memorandum that accompanied the introduction of the legislation. Particular aspects of the group loss rules dealt with in this Ruling are as follows :

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RULING Calculation of loss

3. A loss is deemed by subsection 80(1) to have been incurred by a taxpayer in a year of income in which the allowable deductions, other than concessional deductions and deductions for losses of previous years, exceed the sum of the assessable income (including dividends that are effectively free of tax because of the section 46 rebate) and the net exempt income derived by the taxpayer in that year. The amount of the loss deemed by subsection 80(1) to have been incurred in that year is an amount equal to the excess.

4. The application of subsection 80(1) and the deduction of a loss determined by it for a year of income in a subsequent year is governed by the other provisions of section 80. Sections 80A, 80B, 80DA, 80E and 80F and, to the extent that the loss includes a "film loss" or a "primary production loss", section 80AAA or 80AA, are also relevant for the latter purpose. The right to a deduction for a loss deemed to have been incurred under section 80 (including a film loss or primary production loss) in 1984-85 or a subsequent year of income by a company (termed the "loss company"), may be transferred in accordance with section 80G to another company (termed the "income company"). The "loss company" must be a "group company" in relation to the "income company" in the year in which the loss was incurred, (the "loss year"), the year in which it is to be transferred, (the "income year"), and the intervening years if any. By virtue of subsection 80G(1) a company can be a group company in relation to another company only if one company wholly owns the other or there is a company that, either directly or indirectly, wholly owns each of those companies.

5. The enactment of section 80G does not alter the basic rules for calculating the amount of loss deemed to have been incurred under section 80 or the parts of that loss that come within the scope of section 80AAA or 80AA. Neither does it alter the rules for deduction of a loss once it is transferred from the loss company to the income company. That is to say, for example, that the loss deduction is first offset against any net exempt income of the income company of the year of income before it is deducted from the assessable income, and a film loss deduction is available for offset against the net exempt film income of the income company before it is deducted from assessable film income of the income company. The income company is able to receive a transferred loss deduction in a year of income only to the extent to which the sum of its assessable income and net exempt income (if any) exceeds the deductions otherwise allowable to it, including losses carried forward from previous years but not amounts transferred from a group company (see subsection 80G(7)). A loss may be transferred in the year in which it is incurred or a subsequent year (but subject to the seven year limit contained in subsection 80(2) for non-primary production losses).

Film losses

6. It should be noted that a film loss can be transferred

to an income company to the extent only of the income company's net assessable film income in the year of income. This means that while a company with excess film deductions in a year of income would, if it had other income, offset the film deductions against the other income, it will not be possible for any film loss calculated in accordance with section 80AAA to be transferred and deducted from income other than film income of any other company in that year.

Prior Year losses

7. A company with undeducted prior year losses must offset the losses, in the order in which they were incurred, against its own income (if any) in a year of income before any balance of the losses may be transferred in that year to a group company. The losses available for transfer by a loss company may be transferred only in the order in which they were incurred. Where only some of a company's losses are available for transfer (e.g., because the others were incurred by the company in income years before the 1984-85 income year), they may be transferred, in the order in which they were incurred, leaving those not available for transfer to be carried forward by the company for deduction from its own income in a later year. Therefore, a company that incurred a loss in 1984-85, and has undeducted losses of earlier years, may transfer the 1984-85 loss for deduction from the income of a group company in that income year and carry forward the earlier losses for deduction from its own income.

8. The public officers of companies associated with a transfer must agree to the amount of the loss deduction to be transferred; the amount may be the whole or only part of the loss available for transfer. Moreover, part of the loss incurred in a year of income may be transferred to one group company and the whole or part of the balance transferred to other group companies. As indicated earlier, an income company may receive only sufficient loss deduction to extinguish its own taxable income - it cannot create a loss by way of the transferred loss deduction (subsection 80G(7)).

Common Ownership Test

9. Under section 80G a deduction for a loss may be transferred to another company where at relevant times (subparagraphs 80G(6)(d)(i) and (e)(i)) the company that incurred the loss is a group company in relation to the company to which the loss is to be transferred. Subsections 80G(1)-(5) are relevant in determining whether there is a group relationship between companies in a year of income.

10. Subsection 80G(1) provides that a company is to be taken as a group company in relation to another company in relation to a year of income, if:

- (a) one of the companies was a subsidiary of the other company (paragraph 80G(1)(a)); or

- (b) each of the companies was a subsidiary of the same company (paragraph 80G(1)(b)),

during the whole of the year of income, or if either or both of the companies were in existence during part only of the income year, during the part of the year of income that they were both in existence. Subsection 80G(5), discussed in paragraphs 20 - 21, sets out the circumstances in which a company is to be taken to be in existence.

11. To establish a group relationship it is not necessary for each of the tests specified in subsection 80G(1), taken individually, to be satisfied during the whole of the relevant period. The group relationship will be established if, for example, one of the tests is satisfied for part only of the relevant period and the other test for the balance of the period.

Substituted accounting period

12. Where a company has adopted a substituted accounting period in lieu of a year of income ending 30 June for income tax purposes, the common ownership test between it and another company must be met throughout the whole of the period covering that accounting period and the comparable year of income or accounting period of the related company, if the companies are to be group companies in relation to each other for the year of income. For example, a company that has an accounting period ended 31 March 1986 in substitution for the income year ended 30 June 1986, will be a group company in relation to a company with a regular accounting period for the 1985-86 income year only if the alternative tests (a) or (b) in paragraph 10 above are satisfied (either individually or taken together) for the 15 month period from 1 April 1985 to 30 June 1986. Similarly, a company that has an accounting period ended 31 March 1986 in substitution for the income year ended 30 June 1986, will be a group company in relation to a company with an accounting period ended 30 September 1986 in substitution for the income year ended 30 June 1986, only if those tests are satisfied for the 18 month period from 1 April 1985 to 30 September 1986.

Subsidiary relationship

13. The circumstances in which a company is to be taken to be a subsidiary of another company, for the purposes of establishing whether those companies are group companies in relation to each other for the purposes of section 80G, are set out in subsection 80G(2).

14. Subsection 80G(2) outlines three situations in which a company is to be taken to be a subsidiary of another company (termed the "holding company") during a "relevant period", being the whole or a part of a year of income. They are -

- (a) all the shares in the company were beneficially owned by the other company, i.e., the "holding company", at all times during the relevant period

Company D is a subsidiary of Company A (subparagraph (2) (a) (ii)).

Each of companies A, B, C and D is a group company in relation to each other -

A and B are group companies in relation to each other - paragraph (1) (a) and (2) (a) (i)

A and C are group companies in relation to each other - paragraph (1) (a) and (2) (a) (i)

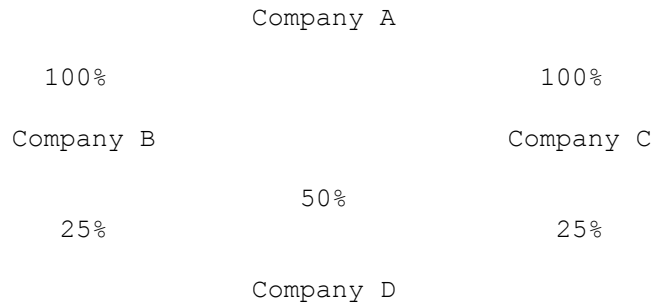
B and C are group companies in relation to each other - paragraph (1) (b) and (2) (a) (i)

A and D are group companies in relation to each other - paragraph (1) (a) and (2) (a) (ii)

B and D are group companies in relation to each other - paragraph (1) (b), (2) (a) (i) and (2) (a) (ii)

C and D are group companies in relation to each other - paragraph (1) (b), (2) (a) (i) and (2) (a) (ii)

EXAMPLE 3



Companies B and C are subsidiaries of Company A (subparagraph (2) (a) (i)).

Company D is a subsidiary of Company A (subparagraph (2) (a) (iii)).

Each of companies A, B, C and D is a group company in relation to each other -

A and B are group companies in relation to each other - paragraph (1) (a) and (2) (a) (i)

A and C are group companies in relation to each other - paragraph (1) (a) and (2) (a) (i)

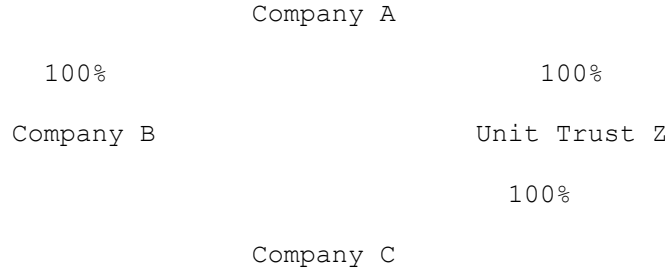
B and C are group companies in relation to each other - paragraph (1) (b) and (2) (a) (i)

A and D are group companies in relation to each other - paragraph (1) (a) and (2) (a) (iii)

B and D are group companies in relation to each other - paragraph (1)(b), (2)(a)(i) and (2)(a)(iii)

C and D are group companies in relation to each other - paragraph (1)(b), (2)(a)(i) and (2)(a)(iii).

EXAMPLE 4



Companies B and C are subsidiaries of Company A (subparagraph 2(a)(i)).

Each of companies A, B and C is a group company in relation to each other.

A and B are group companies in relation to each other - paragraph (1)(a) and (2)(a)(i).

A and C are group companies in relation to each other - paragraph (1)(a) and (2)(a)(i).

B and C are group companies in relation to each other - paragraph (1)(b) and (2)(a)(i).

17. While, in examples 2 and 3, Companies B and C are not directly connected and while, in example 3, the shares in Company D are not owned as to 100% by Company A, B or C, each company is still a group company in relation to any of the others, including Company A, for the purposes of section 80G. Example 4 outlines the situation where a trust estate is part of the grouping arrangement. It will be noted that group relationships between each of the companies are established without the aid of subsection (3).

18. Subsection 80G(3) will need to be called in aid where there is a need to establish a group relationship between 2 companies that are separated by more than one level of ownership. Thus -

EXAMPLE 5



		subparagraph (2) (a) (i)
Company C	100%	Company C is a subsidiary of Company B - subparagraph (2) (a) (i); and a subsidiary of Company A - subparagraph (2) (a) (ii)
Company D		Company D is a subsidiary of Company C - subparagraph (2) (a) (i); and a subsidiary of Company B - subparagraph (2) (a) (ii)

Without the aid of subsection (3) Company D is not a subsidiary of company A. Its shares are not all owned by Company A (subparagraph (2) (a) (i)) or by Company B (a company that, without the aid of subsection (3), is a subsidiary of A), and a reference in subsection (2) to "subsidiary company" does not include a reference to a company that is a subsidiary by reason of another application of the section. That is to say, D is not under subsection (2) a subsidiary of A by reason of the fact that all of the shares in D are owned by C which is a subsidiary of A only by the application of subparagraph (2) (a) (ii). With the aid of subsection (3), however, Company C, being a subsidiary of Company B, is for the the purposes of section 80G a subsidiary of Company A. This having been established, Company D acquires the status of a subsidiary of Company A by the application of subparagraph (2) (a) (ii).

Beneficial ownership

19. Subsection 80G(2) requires all the shares in a company to be beneficially owned at all times during the relevant period (as defined therein) by the requisite company (or companies) before it can be taken to be a subsidiary of another company. In this context "all the shares" includes ordinary and preference shares. Section 80G does not permit the transfer of losses between companies by reason only of the fact that they are each owned by the same natural persons. It is not necessary for the shareholding of each group company in another group company to be constant throughout a year of income to satisfy the subsidiary relationship tests in subsection 80G(2). For instance, where a company that had been wholly-owned by Company A issues shares during a year of income to another company that is also wholly-owned by Company A the 3 companies will still satisfy the group relationship test in the year of income.

EXAMPLE 6

1 July 85 to 31 December 85		1 January 1986 to 30 June 86	
Company A		Company A	
100%	100%	50%	100%
Company B	Company C		Company C

Company B

For the period 1 July 1985 to 31 December 1985 each of Companies B and C is a subsidiary of A by virtue of subparagraph (2) (a) (i). On 1 January 1986, Company B issues to Company C shares equal in number to those held by Company A. For the period 1 January 1986 to 30 June 1986, Company C is a subsidiary of A by virtue of subparagraph (2) (a) (i) and Company B is a subsidiary of A by virtue of subparagraph (2) (a) (iii). Both Companies B and C are therefore group companies in relation to A (paragraph (1) (a)) and group companies in relation to each other by virtue of paragraph (1) (b).

Company in existence

20. Subsection 80G(5) is an explanatory provision that relates to subsection 80G(1) and provides that a company is to be taken to be in existence from the time it is incorporated until the time it is dissolved.

21. Section 80G was amended by the Taxation Laws Amendment Act (No.4) 1987 to give effect to the Treasurer's statement of 24 June 1987 (Press Release No.61) to allow a "shelf company" (a newly incorporated company which had never operated) to satisfy the group relationship test. The amendment by the (No.4) Act introduced subsection 80G(5A) and applies for the 1986-87 or a subsequent year of income. A further amendment proposed by the Taxation Laws Amendment Bill (No.5) 1987 will back-date the "shelf company" amendment to apply from the 1984-85 year of income.

Collateral agreements to circumvent shareholding test

22. Two other provisions are relevant in determining whether the common ownership test is satisfied between companies - paragraph 80G(2) (b) and subsection 80G(4). They operate as a safeguard against the possibility of any collateral arrangement being used to circumvent the shareholding test to establish common ownership.

23. In this regard, a security arrangement made by a holding company, solely for the purposes of a genuine financing transaction, which does not affect the holding company's full beneficial interest in the shares in, and the dividends paid by, the subsidiary company, would not be treated as requiring the application of paragraph 80G(2) (b) to deny a subsidiary relationship.

24. It will be necessary, of course, for the Commissioner to be satisfied that the execution of the security arrangement is not intended to create a situation in which the lender, unless an event of genuine default occurs, could affect the right of the holding company to go on exercising its existing rights in the subsidiary company.

25. A case in point is the granting by a holding company of a legal mortgage over the shares of a subsidiary company, such that the mortgagee is made the shareholder of the shares at company law. If the subsidiary company is to be treated as a subsidiary for section 80G purposes, it will be necessary to show that it is not intended by the execution of the share mortgage :

- (a) to create a situation in which the security trustee, unless in the exercise of security powers where an event of default occurs, could prevent or vary in any way the right of the holding company to go on exercising its existing rights under the relevant shares in the subsidiary company; or
- (b) to alter the incidence of taxation for either party from that which would have prevailed had the financial accommodation been secured by other than the legal mortgage.

Transfer of loss - disqualifying event

26. The transfer from a loss company to an income company of the right to a deduction for a loss is permitted only in respect of a loss that is deemed to have been incurred in the year of income that commenced on 1 July 1984 (or the accounting period adopted in lieu thereof) or in a subsequent year of income (paragraph 80G(6)(a)). By subsection (9), however, section 80G does not permit the transfer of the right to a deduction for a loss in the year in which it is incurred if the current year loss provisions - Subdivision B of Division 2A of Part III of the Assessment Act comprising sections 50A-50N - have applied in the determination of the amount of that loss, i.e., where, as a result of the application of those provisions the amount of the section 80 loss is less than it would otherwise have been. This will be the case where, in that year, a "disqualifying event" is deemed, by section 50H, to have occurred in relation to a company, e.g., a change in the ownership of shares carrying 50% or more of the voting power of the company. The restriction imposed by subsection 80G(9) does not affect the availability of the loss for transfer in a subsequent year of income where the conditions of subsection 80G(6) are satisfied.

Substituted accounting period

27. Where a loss company has an irregular accounting period the right to a deduction for a loss incurred in the accounting period that is substituted for the year of income that commenced on 1 July 1984 may be transferred to a group company even though that accounting period commenced before 1 July 1984. Likewise, an income company that has, or would but for the operation of section 80G have, a taxable income in the accounting period that is substituted for the year of income that commenced on 1 July 1984, may have transferred to it the right to a deduction for a loss incurred by a group company in that year even though the

accounting period of the income company commenced before 1 July 1984.

Transfer of right to a loss deduction - tests to be satisfied

28. Where a loss company seeks to transfer the right to a deduction for a loss to an income company in the year of income in which the loss is incurred, two tests specified in paragraph 80G(6) (d) must be satisfied-

- (a) the loss company must be a group company in relation to the income company in relation to the year in which the loss is incurred (subparagraph (d) (i)); and
- (b) had the loss company incurred the loss in the immediately preceding year of income and had it derived sufficient assessable income (including film income) in the current year, it would have been entitled in the current year to a deduction for the loss under section 80, 80AAA or 80AA (subparagraph (d) (ii)).

Paragraph 80G(6) (f) operates in conjunction with paragraph (6) (d) so that a loss transferred in a year of income in which the loss is incurred is deemed to be a loss incurred by the income company for the purposes of section 80, 80AAA or 80AA, as the case requires, in the year preceding the year of income. This means that the transferred loss will be treated as a loss deductible in accordance with subsection 80(2), 80AAA(7) or 80AA(4), as the case requires, and diminished by any net exempt income of the income company of the year of income. A transferred film loss (subsection 80AAA(7)) as reduced by net exempt film income will be deductible only from net assessable film income of the income company even though the film loss could have been deducted by the loss company from other income if it had had sufficient other income in the loss year. A loss transferred in the year of income in which it was incurred and deemed in relation to the income company by paragraph 80G(6) (f) to be a loss incurred in the preceding year, will not be diminished by any assessable income or exempt income of the income company in that preceding year. Neither will it be subject to the provisions of sections 80A, 80B, 80DA and 80E (the "continuing ownership" and "same business" tests). That is, the transfer of the loss will not be conditional on the continuing ownership or same business test being satisfied as between the year of income and the preceding year. This is provided for in subsection 80G(14). Note, however, that there is no specific restriction on the application of section 80F in relation to the operation of subparagraph 80G(6) (d) (ii). Further consideration is given to this matter below.

29. Where a loss company seeks to transfer the right to a deduction for a loss to an income company in a year subsequent to that in which it is incurred, paragraph 80G(6) (e) specifies two tests comparable with those in paragraph 80G(6) (d). They are -

- (a) the loss company must be a group company in relation to the income company in relation to the loss year, the income year and any intervening year or years (subparagraph (e) (i)); and
- (b) had the loss company derived sufficient assessable income (including film income) in the income year, it would have been entitled in that year to a deduction for the loss incurred in the earlier year (subparagraph (e) (ii)).

30. Like paragraph 80G(6) (d), paragraph 80G(6) (e) requires that the loss company and the income company be group companies at relevant times and that the loss would have been allowable as a deduction to the loss company if it had sufficient income in the year it is to be transferred. Paragraph 80G(6) (g) operates in conjunction with paragraph 80G(6) (e) so that a loss transferred in a year of income subsequent to that in which it was incurred is deemed to be a loss incurred by the income company for the purposes of section 80, 80AAA or 80AA, as the case requires, in the year of income in which the loss was incurred by the loss company. This means that the transferred loss will be treated as a loss deductible in accordance with subsection 80(2), 80AAA(7) or 80AA(4) as the case requires. In the absence of a provision comparable with subsection 80G(14), a loss is not transferable where paragraph 80G(6) (e) applies if either the loss company or the income company is not able, as between the income year and the loss year, to satisfy the requirements of the "continuing ownership" test or the "same business" test (sections 80A to 80E).

31. If these tests are met the loss will be dealt with in the same manner as one to which paragraph 80G(6) (d) applies. A loss to which paragraph 80G(6) (e) applies will not, of course, be diminished by any assessable income or exempt income of the income company in a year prior to the income year.

Bad debts - section 80F

32. While sections 80A to 80E do not apply in relation to the loss company for the purposes of the operation of subparagraph 80G(6) (d) (ii) or to the income company where a loss is transferred in the year of income in which it was incurred, there is no specific restriction on the application of section 80F in relation to the operation of that subparagraph. Neither is there any restriction on the application of section 80F for other purposes of section 80G.

33. Where a current year loss, or part of a current year loss, is attributable to a bad debt that would not be deductible but for subsection 63C(1), and the Commissioner is satisfied (paragraph 80F(e)) that the business referred to in paragraph 63C(1) (b) was carried on at the relevant time for the purpose of securing a deduction by virtue of subsection 63C(1), the deduction of that loss in a later year is governed by section 80F. A deduction is denied by section 80F unless the company, at all times during that later year, satisfies the

requirements of paragraphs 80F(f) and (g), i.e., broadly, that throughout the later year it carried on that business and did not derive income from activities it had not entered into before a change in shareholdings that, but for subsection 63C(1), would have resulted in a deduction being denied by section 63A.

34. Because of the elements that enter into the application of section 80F, e.g., the date a debt was incurred (subsection 63C(1)), the date of a disqualifying change in shareholdings (subsection 63A(2) and 63C(1)), the year in which a debt is written off (subsection 63C(1)), the identity of the business carried on at specified times, and the requirements of paragraphs 80F(f) and (g), it is not possible to apply section 80F to the notional situation provided for in subparagraph 80G(6)(d)(ii). It follows that subparagraph 80G(6)(d)(ii) will not operate to deny the transfer of the right to a deduction for a section 80, 80AAA or 80AA loss, to the extent to which it is attributable to a bad debt, by reason only that the allowance of a deduction to the loss company for the loss in a later year would be dependent upon the requirements of section 80F being satisfied in that later year. Where, however, a loss to which section 80F applies is to be transferred in a year subsequent to that in which it is incurred, the requirements of section 80F will, by the operation of subparagraph 80G(6)(e)(ii), have to be satisfied. If those requirements are satisfied the loss will be transferable subject to the same conditions as any other loss.

35. Neither paragraph 80G(6)(f) nor paragraph 80G(6)(g) is to be regarded as requiring the income company to meet the requirements of section 80F in relation to a loss transferred under subsection 80G(6) as, by its terms, section 80F is capable of application only in relation to the loss company.

Residency

36. The right to a deduction for a loss may be transferred from a loss company to an income company, where the relevant group relationship exists, only where the loss company was a resident as defined in subsection 6(1) of the Assessment Act in the year of income in which the loss was incurred and the income company is a resident in the year of income in which the right is to be transferred - paragraphs 80G(6)(a) and (b). Where, in a year of income, a resident company has incurred a loss, the right to a deduction for that loss will, subject to the other requirements of sections 80G being met, be transferable to any group company that is a resident in the year in which the loss is to be transferred. The residence of the loss company in a year of transfer that is subsequent to the loss year will not be relevant. Neither will the residence of the income company in a loss year (or any other year) preceding that in which the loss is to be transferred.

Notice in Writing

37. Where the right to a deduction for a loss is to be transferred, the loss company and the income company are required by paragraph 80G(6)(c) to give a notice in writing to

the Commissioner, on or before the date of lodgment of the return of income of the income company, or within such further time as he allows. The notice must be signed by the public officer of each of the companies, stating the amount of the loss deduction to be transferred and the year of income in which the loss was incurred.

38. A notice or a further notice given after the date of lodgment of a return, but before the end of the period allowed for lodging a formal objection against the assessment of the income company for the year to which the notice relates, would generally be accepted in the exercise of this discretion.

39. In exercising the discretion to allow a notice or a further notice to be lodged, it can be expected that the Commissioner will have regard to any changed circumstances of a loss company or an income company that result in an increase in the amount of transferable group losses or the capacity of the income company to absorb them. Where the amount of group losses available for transfer is increased after the objection period (if applicable) has expired, the discretion would generally be exercised if a notice or further notice were to be lodged promptly after the increased amount of group losses is established. However, it should not be assumed that the discretion will be exercised in a case in which the capacity to absorb a group company loss has increased as a result of the discovery of an omission of income or an overclaimed deduction by the income company and the adjustment of the taxable income results in the imposition of penalty under Part VII of the Assessment Act. For example, the discretion would not be exercised where a false statement has resulted in the investment allowance being allowed on second-hand plant, and as a result of audit action the disallowance of the deduction results in an increased taxable income. Each case will be treated according to its particular facts. It should be noted, also, that subsection 170(4) of the Assessment Act effectively excludes the extension of the time for lodging a notice or further notice to a date more than 3 years from the date on which an assessment becomes due and payable.

Payment for right to benefit of loss deduction

40. Subsections 80G(17) and (18) relate to payments made by an income company to a loss company as consideration for the transfer of the right to a deduction for a loss. Subsection 80G(17) deals with the situation where the loss company is a shareholder in the income company and in effect provides that a payment received by the loss company as consideration for the transfer of the right to a deduction for a loss will not be treated as income of the loss company to the extent that, in the opinion of the Commissioner, the payment is consideration for the transfer. In forming his opinion the Commissioner will have regard to the amount of the loss deduction transferred and the prevailing rate of tax applying to the income company in the year of income in which the loss deduction is utilised.

41. Subsection 80G(18) specifically provides that a

deduction is not allowable to the income company for any payment it makes to the loss company for the right to a transferred loss deduction.

42. The matter of the application of the capital gains tax provisions of the Assessment Act to the loss company and the income company in relation to the transfer of a loss is under consideration.

COMMISSIONER OF TAXATION
4 February 1988