LCR 2019/1 - The business continuity test - carrying on a similar business

Page status: **legally binding**

The business continuity test – carrying on a similar business

Relying on this Ruling

This publication is a public ruling for the purposes of the Taxation Administration Act 1953.

This Ruling describes how the Commissioner will apply amendments by Schedule 1 to the Treasury Laws Amendment (2017 Enterprise Incentives No. 1) Act 2019.

If you rely on this Ruling in good faith, you will not have to pay any shortfall tax, penalties or interest in respect of matters covered by the Ruling if it does not correctly state how a relevant provision applies to you.

Table of Contents **Paragraph**

What this Ruling is about

1. The 'business continuity test'[1] introduced by the *Treasury Laws Amendment (2017 Enterprise Incentives No. 1) Act 2019* retains the existing 'same business test'[2] and introduces the 'similar business test'.[3] Under the similar business test, companies and listed widely held trusts will be able to utilise tax losses made from carrying on a business

[1] Subdivision 165-E of the *Income Tax Assessment Act 1997* (ITAA 1997) and Subdivision 269-F of Schedule 2F to the *Income Tax Assessment Act 1936* (ITAA 1936).
[2] Section 165-210 of the ITAA 1997 and section 269-100 of Schedule 2F to the ITAA 1936.
[3] Section 165-211 of the ITAA 1997 and section 269-105 of Schedule 2F to the ITAA 1936.

against income derived from carrying on a similar business following a change in ownership or control.

2. This Ruling provides guidance on what carrying on a similar business means.

Date of effect

3. The similar business test broadly applies to:

- a tax loss incurred for income years beginning on or after 1 July 2015 (including, by virtue of section 65-40 of the ITAA 1997, a tax offset the company has carried forward where the company became entitled to the tax offset in income years beginning on or after 1 July 2015)
- a net capital loss made for income years beginning on or after 1 July 2015
- working out the taxable income and tax loss, and net capital gain and net capital loss, in an income year beginning on or after 1 July 2015 because a change of ownership has occurred in that income year[4]
- an unrealised loss in relation to a CGT asset[5], where the income year immediately before the one in which a change of ownership or control occurs is an income year beginning on or after 1 July 2015, and
- a debt incurred in income years beginning on or after 1 July 2015 that the company writes off as bad.[6]

4. For listed widely held trusts, which are subject to Subdivision 266-D of Schedule 2F to the ITAA 1936, the similar business test applies to:

- a tax loss incurred for income years beginning on or after 1 July 2015
- working out the net income and tax loss for an income year beginning on or after 1 July 2015 for the purposes of Division 268 of Schedule 2F to the ITAA 1936[7]
- a debt incurred in income years beginning on or after 1 July 2015 that the trust writes off as bad, and
- a debt incurred in income years beginning on or after 1 July 2015, in relation to which a debt/equity swap (within the meaning of section 63E of the ITAA 1936) occurs.

5. Where losses are transferred from a joining entity to the head company of an income tax consolidated group in an income year that commences on or after 1 July 2015, the head company can only apply the similar business test to a tax loss or net capital loss that was originally incurred by the joining entity for an income year starting on or after 1 July 2015.[8]

The similar business test

6. The similar business test operates in a way that is comparable to the same business test[9], but removes the negative limbs which apply as part of that test.[10] These

[4] Subdivisions 165-B and 165-CB of the ITAA 1997.
[5] Subdivision 165-CC of the ITAA 1997.
[6] Under subsection 63E(5A) of the ITAA 1936, deductions for debt/equity swap losses are subject to the same recoupment rules (such as the business continuity test) as bad debts.
[7] Division 268 of Schedule 2F to the ITAA 1936.
[8] Subsection 707-140(1A) of the ITAA 1997. See paragraphs 1.55 and 1.56 of the Explanatory Memorandum to the *Treasury Laws Amendment (2017 Enterprise Incentives No. 1) Bill 2017* (EM).
[9] Paragraph 1.20 of the EM.

negative limbs deny access to losses where activities or transactions are new and of a different kind to those entered into or carried on before a change in ownership or control. Removal of the negative limbs will allow companies and listed widely held trusts to engage in new business activities and transactions that evolve from their pre-existing business, without losing access to their unutilised losses, encouraging innovation.

7. It is still the case, however, that the overall business must satisfy the similar business test. The meaning of 'similar' depends on the context in which the term arises.[11] In the context of the similar business test, 'similar' does not mean similar 'kind' or 'type' of business. The focus remains on the identity of a business, as well as continuity of business activities and use of assets to generate assessable income.[12] Accordingly, it will be more difficult to satisfy the similar business test if substantial new business activities and transactions do not evolve from, and complement, the business carried on before the test time. In contrast, where a company develops a new product or function from the business activities already carried on, and this development opens up a new business opportunity or allows the company to fill an existing gap in the market, the business as a whole is likely to satisfy the similar business test.

8. For the purpose of determining whether a business remains sufficiently similar, the four factors that must be taken into account require a comparison between the essential characteristics of the business before and after the relevant change in ownership or control.[13] These four factors do not limit consideration of any other matter that may be relevant to this determination. The weight to be given to each factor will depend on the facts and circumstances of each case.

9. The first factor considers the extent to which the assets used to generate assessable income throughout the business continuity test period were the assets used in the business carried on at the test time.[14] Where the same assets of the business are being used as at the test time to generate assessable income, albeit that they may be producing a different result or effect due to the development or commercialisation of some of those assets, this factor would indicate that the business remains similar to that previously carried on.

10. The continuing use of certain business assets to generate assessable income rather than other assets may be more relevant to the question of whether the similar business test is passed. For example, goodwill, which is the combined result of using the business' tangible, intangible and human assets in such a way that attracts custom to the business, will be more relevant than other assets, such as generic office premises, equipment and stationery, because it is closely linked to the identity of a particular business. If the goodwill that was used throughout the business continuity test period is replaced by new goodwill[15], it will be necessary to consider the extent to which other assets of the business have continued to be used and the amount of weight that should be given to that in comparison to other factors.

11. The second factor compares the extent to which the current activities and operations from which assessable income is generated were also those from which assessable income was generated previously.[16] Where the business operator maintains the income generating activities and operations that were previously being undertaken,

[10] Paragraphs 165-210(2)(a) and (b) of the ITAA 1997 and paragraphs 269-100(3)(a) and (b) of Schedule 2F to the ITAA 1936.

[11] See the comments of Leeming JA in *FBHS (Aust) Pty Ltd v Stone Homes Pty Ltd* [2014] NSWCA 312 at [39].

[12] Paragraphs 1.20 and 1.21 of the EM.

[13] The testing is undertaken throughout the 'business continuity test period' compared with the business immediately before the 'test time', just as it is for the same business test.

[14] Paragraph 165-211(2)(a) of the ITAA 1997 and paragraph 269-105(3)(a) of Schedule 2F to the ITAA 1936.

[15] See paragraphs 21 to 24 of Taxation Ruling TR 1999/16 *Income tax: capital gains: goodwill of a business*.

[16] Paragraph 165-211(2)(b) of the ITAA 1997 and paragraph 269-105(3)(b) of Schedule 2F to the ITAA 1936.

despite doing them in a different or more efficient way due to business improvements, this factor would indicate that the business remains similar to that previously carried on.

12. The third factor compares the current identity of the business with that of the business carried on before the test time.[17] Where new activities have not resulted in the identity of the business changing, this factor would indicate that the business remains relevantly similar to that previously carried on.

13. The fourth factor requires an assessment of the extent to which the changes to the business resulted from the development or commercialisation of assets, products, processes, services or marketing or organisational methods of the business.[18] As the similar business test is designed to encourage businesses to innovate, such changes will not, in themselves, cause a business to be considered dissimilar. Where changes to the business do not result from such development or commercialisation, the business is less likely to satisfy the similar business test.

14. The first three factors are concerned with the aspects of the business that have continued, while the fourth factor assesses the nature of any changes that have happened. Where those changes are due to an evolution or development of the business, the business is more likely to be similar to that previously carried on.

Example 1 – company engages in development or commercialisation

15. *ToUrDoor Pty Ltd is an established courier company that operates under the brand name 'ToUrDoor'. Its customer base consists primarily of office businesses. ToUrDoor Pty Ltd delivers documents and parcels using its fleet of bicycles, and emphasises its reliable, fast and affordable services. Customers can request a courier service through the ToUrDoor website or app, or by calling their direct telephone number. The bicycles are fitted with GPS tracking and weatherproof, hard-case boxes at the rear. Although the business has been moderately successful, more recently it has been less profitable and made tax losses.*

16. *In an attempt to increase the efficiency of its couriers, the company invests in reviewing its fleet of bicycles, including researching potential new bike designs and the use of lightweight materials. To acquire new funds in order to fund this research, ToUrDoor Pty Ltd gained a new equity investor, causing it to fail the continuity of ownership test.*

17. *The company develops a new bicycle design with a built-in insulated box, which keeps the contents of the box insulated. Whereas previously the box was a separate compartment attached to the rear of the bicycle, it is now built into the side of the bicycle. ToUrDoor Pty Ltd applies for a patent for the design. Overall, the improved design results in cost savings for the company, because it reduces the time taken to complete the deliveries.*

18. *ToUrDoor Pty Ltd sees an opportunity to deliver food using the new bicycle design. Further changes are made to the design to accommodate the storage of food and beverages. This new design opened up a new client base as restaurants and café owners can now make a booking with ToUrDoor, through the existing booking platforms, to have their food delivered to customers. ToUrDoor Pty Ltd charges the restaurant and café owners a comparable fee in the same way it charges for its document and parcel courier service.*

19. *ToUrDoor Pty Ltd satisfies the similar business test because:*

- *although the company uses the new patented bicycle design to provide courier and food delivery services (factor one), and this design was not*

[17] Paragraph 165-211(2)(c) of the ITAA 1997 and paragraph 269-105(3)(c) of Schedule 2F to the ITAA 1936.
[18] Paragraph 165-211(2)(d) of the ITAA 1997 and paragraph 269-105(3)(d) of Schedule 2F to the ITAA 1936.

previously used, this change is solely a result of the research and development that went into developing the new bicycle design (factor four)

- *the same tangible and intangible assets are used to generate assessable income (factor one), in so far as the company continues to generate income from its physical office, employees, trade mark, website and app*
- *the company has also established a new customer base, being restaurant and café owners, as a result of developing the new bicycle design (factor four)*
- *the booking systems on the website and app, as well as the process for placing phone bookings (factor three), have all undergone modifications to accommodate for the additional food delivery service. These modifications resulted from the development of the new bicycle, which allowed the company to diversify its service (factor four)*
- *the core business activity of delivering documents and parcels continues to generate a large majority of the company's assessable income, albeit it has evolved and starts to derive some assessable income from the delivery of food (factor two), and*
- *the company's reputation for providing reliable, fast and affordable courier services has evolved over time, so that their identity is now one of a delivery business that offers a wider range of services (factor three). This shift was a result of the company re-designing its bicycles, modifying the booking process, offering additional services and broadening its marketing audience, all of which resulted from the company engaging in development and commercialisation (factor four).*

Example 2 – company changes income generating activities and the identity of the business

20. *This example is based on the facts at paragraph 15.*

21. *Unlike in Example 1, ToUrDoor Pty Ltd in this instance notices that there is a growing demand for food delivery. Following a change in its ownership (causing it to fail the continuity of ownership test), the company purchases insulated boxes that can be carried by the courier like a backpack. The food delivery service proves to be profitable and generates a large majority of the company's assessable income. The business becomes predominantly about food delivery, and the delivery of documents and parcels (while still part of the business) becomes an ancillary activity.*

22. *ToUrDoor Pty Ltd does not satisfy the similar business test because of the change in the activities from which it generates most of its assessable income (food delivery, as compared to the delivery of documents and parcels) (factor two). There is also a change in the identity of the business, from a courier business to a delivery business with a focus on food (factor three), that did not stem from ToUrDoor Pty Ltd's development of assets, processes or services (factor four). The business is not sufficiently similar for the purposes of the test.*

Example 3 – physical clothing retailer shop moves to an exclusively online platform

23. *Kool Rags Pty Ltd is a clothing retailer which carries its own line of casual wear under the brand name 'Rags'. The clothes are manufactured offshore and sold through the company's physical stores in Melbourne and Sydney. Goods are stored in warehouses in both cities, before they are transported to the physical stores when stock needs to be replenished. It originally had a website which contained photographs of clothes and store locations.*

24. *A majority of the shares in Kool Rags Pty Ltd is acquired by a large retail group, causing it to fail the continuity of ownership test. Over a period of five years, the company transitions to a purely online clothing retailer in response to changing shopping trends and the greater functionality of technology. The company makes a number of changes to increase its online sales, including:*

- *engaging a website designer to create a fully-responsive website from which customers can order clothes and seek live-chat assistance*
- *renting larger warehouses in Melbourne and Sydney to store the clothing goods*
- *allowing customers to choose between home delivery and collecting their order from various parcel pick-up locations. Kool Rags Pty Ltd despatches the orders straight from the warehouse to its customers or a parcel pick-up location*
- *hiring a marketing agency to manage its multiple social media platforms, and*
- *using web analytics to create targeted advertisements on social media platforms and generate personalised newsletters.*

25. *Kool Rags Pty Ltd satisfies the similar business test because:*

- *the company's tangible and intangible assets, including its head office, employees, and trade mark, are used to the same degree in its online clothing business to generate assessable income (factor one)*
- *the goodwill generated from its brand name 'Rags' is retained in the online clothing business. Kool Rags Pty Ltd has also generated new goodwill from the commencement of the online store, but this has been created from the development of the online platform and the commercialisation of that platform through the use of web analytics (factor four)*
- *the company's core business activity, being the sale of its own brand of clothing, continues to generate assessable income to the same degree in Kool Rags Pty Ltd's online clothing business (factor two)*
- *although the company has changed its sales channel from multiple physical stores to an online platform (factor two), this is merely a new, and more efficient, way of undertaking the same income-generating activities which resulted from the development and commercialisation of the online platform (factor four)*
- *the change in warehouses to accommodate more stock was a consequence of the company's evolution to an exclusively online platform (factors one and four), and*
- *while the company no longer interacts with its customers face-to-face, it continues to interact with customers as part of its business activities albeit in an online environment (factor two). These online interactions include live-chat assistance with sizing, order confirmation emails, shipping notification emails and tracking facility and newsletters, which resulted from the development and commercialisation of its online platform (factor four).*

Example 4 – fast food restaurant completely changes its food offering and operates under a new brand name

26. *Mad Cow Ltd owns and operates a fast food restaurant under the name 'MuBurger' on the Gold Coast. The restaurant sells an affordable range of burger varieties, fries, soft drinks and milkshakes. The 'MuBurger' logo contains a cartoon cow, and the restaurant*

layout is fitted out with distinctive black and white furnishings. The company had once operated a small chain of 'MuBurger' fast food restaurants, all with the same logo, branding, layout, and product mix. However, the company has suffered from a downturn in profitability and has made substantial tax losses.

27. *The majority shareholder of Mad Cow Ltd sells their shares, causing it to fail the continuity of ownership test. Mad Cow Ltd then decides to rebrand the business. As part of the rebranding process, it:*

- *hires a new manager to oversee the business*
- *hires a marketing agency to manage its online platforms in order to build its online presence and interact with its customer base*
- *changes its brand name to 'Healthy Food Artists' and engages a graphics designer to design a new, catchy logo, and*
- *retains the business premises, but transforms the layout of the restaurant to make it more contemporary.*

28. *Under the new brand name 'Healthy Food Artists', the menu has a focus on full, hearty meals and the company markets itself as a family restaurant providing high quality steaks, ribs, and gourmet burgers sourced from prime Queensland beef for a premium price.*

29. *Mad Cow Ltd does not satisfy the similar business test because:*

- *the company no longer generates assessable income from the brand name 'MuBurger', which was previously a key asset of the business (factor one). The change from 'MuBurger' to 'Healthy Food Artists' does not result from development or commercialisation. Rather, Mad Cow Ltd has attempted to present itself to the public as a new and different business, such that its essential nature or character is no longer the same. The goodwill associated with the new brand name is unique to Mad Cow Ltd's new business (factor four)*
- *although the company retained a number of its original suppliers and its food preparation processes (factor two), the complete transformation of the identity of the business, through its change to the restaurant layout, branding and logo (factor three), does not result from the company developing or commercialising any part of the business carried on previously (factor four), and*
- *the new marketing strategy adopted in the company's current business, devised with the help of the marketing agency to increase sales (factor two), is unique to the new business and also did not result from any development or commercialisation undertaken by the company (factor four).*

Example 5 – gold mining business to mixed mining business

30. *Mammon Ltd is a gold mining company that operates a site in New South Wales. The company had previously carried out exploration activities which revealed that the gold ore also contained traces of copper. Mammon Ltd applied for, and was granted, a mining tenement, which permits the company to extract, process and refine gold and copper from the ore.*

31. *As part of the process for extracting gold, the copper in the ore is either wasted or it can be recovered provided that further systems are installed. As copper prices were low and there was little demand for the product, the company did not consider it commercially viable to install the necessary systems to process copper concentrate. As such, Mammon*

Ltd's business activity involved extracting the gold and selling the refined product to customers worldwide.

32. *Mammon Ltd incurs large tax losses due to a recent drop in gold prices and the majority shareholder sells their shares, causing it to fail the continuity of ownership test. After this change in ownership, there is a sharp increase in copper prices and Mammon Ltd decides to start processing copper concentrate from the extracted gold ore for sale. The company invests in new equipment to process the copper concentrate from the ore, as well as hiring trained staff.*

33. *The company commences selling the copper, although the assessable income generated from the sale of copper is insignificant compared to the revenue Mammon Ltd derives from selling gold. Mammon Ltd would satisfy the similar business test because:*

- *the mining lease, which is a key asset of the company, is used to the same degree in Mammon Ltd's business as it permits the mining of gold and copper (factor one)*
- *the new equipment acquired to enable the processing of copper forms a small part of Mammon Ltd's core business activities, being the extraction, refining and sale of gold (factor one)*
- *the company continues to generate its assessable income primarily from its core business activities of gold mining. Due to the copper mining activities generating comparatively insignificant assessable income, there is very little change to the activities which generate assessable income (factor two)*
- *the acquisition of new equipment to facilitate the processing of copper concentrate (factor one) is a result of Mammon Ltd evolving. The recovery of the copper as part of its gold mining business has always been envisaged as a possibility during the exploration stage and at the time Mammon Ltd applied for a mining tenement, and*
- *as the copper production is relatively insignificant to its gold production activities, the overall identity of the business remains sufficiently similar (factor three).*

34. *This example illustrates, in particular, the effect of removing the negative limbs of the same business test. Although the activity of processing and selling copper has not previously been carried on by Mammon Ltd, this new business activity will not alone cause the failure of the business continuity test if the company otherwise satisfies the similar business test.*

Commissioner of Taxation
22 May 2019

References

Previous draft:

Previously released in draft format as LCR 2017/D6

ATOlaw topic(s)	Income tax ~~ Tax losses ~~ Other
Legislative references	ITAA 1936 ITAA 1936 63E ITAA 1936 63E(5A) ITAA 1936 Sch 2F Subdiv 266-D ITAA 1936 Sch 2F Div 268 ITAA 1936 Sch 2F Subdiv 269-F ITAA 1936 Sch 2F 269-100 ITAA 1936 Sch 2F 269-100(3)(a) ITAA 1936 Sch 2F 269-100(3)(b) ITAA 1936 Sch 2F 269-105 ITAA 1936 Sch 2F 269-105(3)(a) ITAA 1936 Sch 2F 269-105(3)(b) ITAA 1936 Sch 2F 269-105(3)(c) ITAA 1936 Sch 2F 269-105(3)(d) ITAA 1997 ITAA 1997 65-40 ITAA 1997 165-210 ITAA 1997 165-210(2)(a) ITAA 1997 165-210(2)(b) ITAA 1997 165-211 ITAA 1997 165-211(1) ITAA 1997 165-211(2)(a) ITAA 1997 165-211(2)(b) ITAA 1997 165-211(2)(c) ITAA 1997 165-211(2)(d) ITAA 1997 Subdiv 165-B ITAA 1997 Subdiv 165-CB ITAA 1997 Subdiv 165-CC ITAA 1997 Subdiv 165-E ITAA 1997 707-140(1A) Treasury Laws Amendment (2017 Enterprise Incentives No. 1) Act 2019 Sch 1
Related Rulings/Determinations	TR 1999/9 TR 1999/16 TR 2007/2
Case references	FBHS (Aust) Pty Ltd v Stone Homes Pty Ltd [2014] NSWCA 312
Other references	Explanatory Memorandum to the Treasury Laws Amendment (2017 Enterprise Incentives No. 1) Bill 2017
ATO references	1-B0HE455
BSL	TCN