


TD 2006/D38 - Income tax: consolidation: can a tax loss, transferred 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, satisfy the condition described in paragraph 707-350(1)(c) of the Income Tax (Transitional Provisions) Act 1997?

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This document has been finalised by TD 2006/76.



Draft Taxation Determination

Income tax: consolidation: can a tax loss, transferred 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, satisfy the condition described in paragraph 707-350(1)(c) of the *Income Tax (Transitional Provisions) Act 1997*?

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Ruling

1. No. A tax loss that is transferred to the extent it could have been utilised by the transferor in the trial year under section 165-20 of the *Income Tax Assessment Act 1997* (ITAA 1997) is not transferred because the real loss-maker met the conditions in section 165-12 of the ITAA 1997. As a result, the loss cannot be utilised under the alternative loss utilisation regime (the '1/3rd method') described in section 707-350 of the *Income Tax (Transitional Provisions) Act 1997* (IT(TP)A).

Example

2. Parent Co acquired 100% of the shares in A Co on 1 March 1999 and immediately changed its business. A Co incurred a tax loss of \$50,000 for the income year ending 30 June 1999. It is established that \$10,000 of the tax loss was incurred after the ownership change on 1 March 1999 for the purpose of applying section 165-20 of the ITAA 1997.

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3. *A Co joins the consolidated group formed by Parent Co on 1 July 2003. A Co's 1998/1999 tax loss is tested at the joining time to determine whether it is transferred to Parent Co.*
4. *A Co fails the continuity of ownership test (COT) in respect of the 1998/1999 tax loss as a change in ownership of A Co occurred on 1 March 1999. A Co is also unable to satisfy the same business test in respect of the loss as its business changed after 1 March 1999.*
5. *\$10,000 of the 1998/1999 tax loss that was incurred after the change in ownership is able to be transferred to Parent Co. This part of the tax loss could have been utilised in the trial year on the assumptions in subsection 707-120(1) of the ITAA 1997 as the COT is satisfied if the part of the loss year after 1 March 1999 is treated as the whole loss year.*
6. *However, the tax loss is unable to be utilised under the 1/3rd method as the loss did not meet the conditions in section 165-12 of the ITAA 1997. The 1998/1999 tax loss was transferred to the extent that \$10,000 of the loss was able to be utilised in the trial year under section 165-20 of the ITAA 1997. It must be utilised under the available fraction method.*

Date of effect

7. 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

8. 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.

9. 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, the IT(TP)A and the *Income Tax Assessment Act 1936* is a reference to a loss that was incurred for an income year.³

10. 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

11. 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 of the ITAA 1997 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.

12. 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.

13. 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.

14. The subsequent utilisation of losses that are transferred to the head company of a consolidated group is governed by Subdivision 707-C of the ITAA 1997. Broadly, losses can only be utilised for an income year against a fraction of the income generated by the group. This method is referred to as the 'available fraction method'.

15. An alternative method for utilising transferred losses, the 1/3rd method, is available for certain losses that were transferred to the head company during the transitional period (1 July 2002 to 30 June 2004). This method, outlined in subsection 707-350(3) of the IT(TP)A, replaces the limits on utilisation that would otherwise apply under the available fraction method.

16. The conditions in subsection 707-350(1) of the IT(TP)A must be satisfied in order for the loss to be eligible to be utilised under the 1/3rd method⁷. Paragraph 707-350(1)(c) of the IT(TP)A outlines the following condition in respect of all losses in a bundle of losses:

- (c) they were transferred to the transferee from the real loss-maker because:
 - (i) the real loss-maker met the conditions in section 165-12 of that Act; and
 - (ii) the conditions in one or more of paragraphs 165-15(1)(a), (b) and (c) did not exist in relation to the real loss-maker; and

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 satisfy this condition. The words 'one or more losses' in subsection 707-350(1) of the IT(TP)A are a reference to the tax loss made for an income year. The requirement in subparagraph 707-350(1)(c)(i) of the IT(TP)A is that the real loss-maker must meet the conditions in section 165-12 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 paragraph 707-350(1)(c) of the IT(TP)A cannot be satisfied because the real loss-maker 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 real loss-maker 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 satisfy the conditions in paragraph 707-350(1)(c) of the IT(TP)A the tax loss cannot be utilised under the 1/3rd method. This means the tax loss, to the extent it is able to be transferred, must be utilised under the available fraction method.

⁷ The loss has to have been originally incurred by a company for an income year ending on or before 21 September 1999 and transferred to the head company when the group first formed.

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.)

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TD 2006/D37

Subject references:

- concessional losses
- consolidation - continuity of ownership test
- consolidation - losses
- tax loss
- transfer of losses
- transferred losses
- utilise a loss
- year of income

- 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 707-120
- ITAA 1997 707-120(1)
- ITAA 1997 707-120(2)
- ITAA 1997 Subdiv 707-C
- IT(TP)A 1997 707-350
- IT(TP)A 1997 707-350(1)
- IT(TP)A 1997 707-350(1)(c)
- IT(TP)A 1997 707-350(1)(c)(i)
- IT(TP)A 1997 707-350(3)

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
- ITAA 1997 165-13
- ITAA 1997 165-15(1)(a)
- ITAA 1997 165-15(1)(b)

Other references:

- Consolidation Reference Manual 'Transfer testing where control or ownership failure and a change in business within the trial year', C3-3-270
- Consolidation Reference Manual 'Concessional method for utilising transferred losses', C3-4-520

ATO references

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