


IT 152 - Tax avoidance schemes: proposed reorganisation of company group - prepayment of interest, transfer of equipment

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TAXATION RULING NO. IT 152

TAX AVOIDANCE SCHEMES : PROPOSED REORGANISATION OF
COMPANY GROUP - PREPAYMENT OF INTEREST, TRANSFER OF
EQUIPMENT

F.O.I. EMBARGO: May be released

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TAX AVOIDANCE SCHEMES
PREPAYMENT OF INTEREST
DEPRECIATION
PRIOR YEAR LOSSES
COMPANY GROUP RE-
ORGANISATION

PART IVA

PREAMBLE

Advice issued to Branch Offices on the question of whether Part IVA legislation has application where a particular group of companies sought to re-organise their business operations.

FACTS

2. The rationalisation proposal involves the transfer of operations into one operating company, the present holding company, A Pty. Ltd., and eventual liquidation of the subsidiaries. The companies have a substituted accounting period ending on 31 March each year and to facilitate the transition it is proposed that the transfer of assets, etc, will take place after the half yearly balance, on 1 October 1981.

3. The subsidiary companies presently have unrecouped tax losses and in some cases bad debts which are yet to be written off. The estimated tax loss position of the companies at 31 March 1981, is as follows:

'B' -	\$244,232
'C' -	794
'D' -	27,020
'E' -	68,920
'F' -	558,763
'G' -	547

'B' and 'E' companies are expected to trade out of their loss situation prior to the takeover on 1 October 1981 but little change is likely in the quantum of losses accumulated by 'D' and 'F'.

4. Book debts which are bad will be written off by the transferor company prior to the transfer and any recoveries of such debts will be returned as income by that company. In discussion it has been indicated that the quantum of such debts is not of significant proportions.

5. The contentious part of the proposal in respect of which a ruling regarding the application of Part IVA is sought concerns equipment on hire and prepayment of interest which will be manipulated to absorb the losses accumulated by 'D' and 'F' thus transferring them to 'A' as at 1 October 1981.

EQUIPMENT ON HIRE

6. It is proposed that the equipment rented to customers will be transferred by 'B' and 'F' at values approximately 5% over writtendown values as follows:

	W.D.V.	TRF TO 'A'	MARK UP
'B'	\$550,079	\$577,000	\$26,921
'F'	\$528,432	\$555,000	\$26,568

It is claimed that the increase is justified because the equipment is monogrammed and, in acquiring this equipment, the company avoids the clerical administrative cost and inconvenience of purchasing new (equipment) and having it monogrammed.

It is assumed the mark up of the 'B' equipment is proposed to provide consistency in treatment of equipment transferred (although no mention is made of the 'E' supplies) and a safeguard in the event that the company is unable to trade out of its loss position completely.

PREPAYMENT OF INTEREST

7. After integration of the group, loans between the companies will comprise amounts associated with normal circulating capital requirements and balance owing by 'A' as a result of takeover of the business assets of its subsidiary companies. The group accountants advise that consistent with common commercial practice within company groups interest has not been and will not be charged on circulating capital balances but it is proposed that interest at 15% per annum payable 2 years in advance on and from 1 October 1981 will apply in respect of amounts owing by 'A' to 'D' and 'F' on transfer of their business assets. It is claimed that, taking into account the lower interest rate which would be expected as a result of prepayment, interest at 15% per annum is commercially realistic in the light of current interest rates charged, by banks and other financial institutions, on unsecured loans of the sizes under consideration.

8. The total interest paid is to be claimed as a deduction by 'A' in the year of income ended 31 March 1982 and will be returned as assessable income by the recipient companies in the same year. Liquidation of 'D' and 'F' will be delayed until expiry of the 2 year loan period.

9. Implementation of the above proposal will involve interest payments by 'A' as follows:

- 'F' - \$510,000 (approximately) based on transfer of net assets valued at approximately \$1,700,000.
- 'D' - \$30,360 based on an outstanding loan balance of \$101,203 as a result of earlier transfer of its business. This is a non-operating company.
- 'B' - Nil. The company believes that it would be commercially unrealistic that interest apply when it has the intention of liquidating the company as soon as possible.
- 'E' - Nil. It is assumed the circumstances are similar to those applicable to 'B'.

The remaining subsidiaries are non-operating companies which are to be liquidated as soon as possible.

10. The proposals outlined above will result in an increase in the income of the undermentioned companies to the extent shown -

	DEPRECIATION RECOUPED	INTEREST PAID IN ADVANCE	TOTAL
'F'	\$26,568	\$510,000	\$536,568
'B'	\$26,921	\$ Nil	\$ 26,921
'D'	\$ Nil	\$ 30,360	\$ 30,360

The income received will absorb most if not all of the losses previously accumulated by 'F' and 'D' and will increase the losses of 'A' by a corresponding amount.

11. It is claimed that the transfer of operations into one operating company will afford improved managerial control of operations, reduce duplication and other costs necessarily resulting from operating through different legal entities and that these economies, together with the enhanced ability to control the group's operations, are an integral part of plans for returning the group to a profitable trading position.

12. For taxation purposes the effect of the proposals is to transfer the losses from 'F' and 'D' to 'A' to be absorbed in the current year or in future years. The objectionable features to the arrangement could fall into two possible areas -

- i. the possible acceleration of absorption of the losses by the prepayment of interest; or
- ii. if current profits of the group are insufficient to cover deductions arising out of the past year losses of the subsidiaries, the effect will be to extend the section 80 loss period in the accounts of 'A'.

RULING 13. The view is taken that Part IVA would not apply to

those elements of the proposed transactions that would give rise to deductions to 'A' for the prepayment of interest on the terms proposed and for depreciation on equipment transferred to it at values approximately 5 per cent in excess of written down values.

COMMISSIONER OF TAXATION