


TD 2006/76 - 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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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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This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*. A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes. If you rely on this ruling, we must apply the law to you in the way set out in the ruling (unless we are satisfied that the ruling is incorrect and disadvantages you, in which case we may apply the law in a way that is more favourable for you – provided we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

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.

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 can only be utilised under the available fraction method.*

Date of effect

7. This Determination applies to years of income commencing both before and after its date of issue. However, the Determination does 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 (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Appendix 1 – Explanation

① *This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the 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 still 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 but 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 assumptions.⁵ 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.

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.

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 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 method.⁷ Paragraph 707-350(1)(c) of the IT(TP)A provides 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, can only 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 – Alternative views

❶ *This Appendix sets out alternative views and explains why they are not supported by the Commissioner. It does not form part of the binding public ruling.*

Alternative views

20. An alternative view would be to restrict the enquiry under paragraph 707-350(1)(c) of the IT(TP)A to the part of the tax loss that was successfully transferred. Section 165-20 of the ITAA 1997 provides for a deduction by 'resetting' the testing parameters to begin at some point after the start of the loss year. The tests outlined in section 165-10 of the ITAA 1997 are applied to this shortened period to determine whether a deduction is available. It could be argued that paragraph 707-350(1)(c) of the IT(TP)A should therefore also have application in reference to that part of the loss year that was examined under section 165-20.

21. The alternative view would conclude that the transfer of a tax loss, to the extent that section 165-20 of the ITAA 1997 would provide a deduction in the trial year, can meet the condition in paragraph 707-350(1)(c) of the IT(TP)A if the real loss-maker meets the conditions in section 165-12 of the ITAA 1997⁸ in respect of the part of the loss year examined under section 165-20. Paragraph 707-350(1)(c) of the IT(TP)A does not specify that the conditions in section 165-12 have to be met in respect of the loss and hence it can be sufficient to meet those conditions via the operation of section 165-20.

22. Under this alternative view, the loss will be eligible to be utilised by the head company under the 1/3rd method provided the other conditions listed in subsection 707-350(1) of the IT(TP)A are also satisfied.

23. This alternative view is not accepted by the Commissioner. It is considered that the conditions in section 165-12 of the ITAA 1997 have to be met in respect of the tax loss in its entirety. The reference to a loss in section 707-350 of the IT(TP)A is a reference to a loss made in respect of an income year. Section 165-20 of the ITAA 1997 does not go so far as to deem the part of the loss that is deductible to be a tax loss incurred in a truncated income year. It only provides for a partial deduction of the tax loss. As such, the reference to 'a loss' throughout Division 707 of the IT(TP)A is a reference to a loss made for an income year, notwithstanding only a portion of that loss incurred in part of the loss year is transferred to the head company.

⁸ Note that paragraph 707-350(1)(c) of the IT(TP)A also requires that the conditions in one or more of paragraphs 165-15(1)(a), (b) and (c) of the ITAA 1997 did not exist.

References

Previous draft:

TD 2006/D38

Related Rulings/Determinations:

TR 2006/10; TD 2006/75

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 Div 707
- 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:

- TAA 1953
- 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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