

Worked example

Transfer testing with modified same business test – acquisition of another consolidated group

Description This example shows how the modified same business test (SBT) applies where the continuity of ownership test (COT) is failed as a result of the head company of a consolidated group being acquired by another consolidated group.

Commentary If a head company of a consolidated group joins another consolidated group, all unutilised carry-forward losses owned by the former head company are tested to determine whether they transfer to the head company of the acquiring group.

Where a consolidated group acquires another consolidated group outright (i.e. a 100% takeover), the COT for transfer testing purposes may be failed on the acquisition date. In this situation, unutilised carry-forward losses are transferred only if an SBT is satisfied. As all the losses being transfer tested are made in an income year starting after 30 June 1999¹, section 707-125 applies (the ‘modified same business test’).

Section 707-125 introduces an additional test point just before the end of the income year in which the loss is made by the joining company, and tests all of the income year that included the test time that would normally apply for the SBT.

Example

Facts A consolidatable group, Small Group, consolidates on 1 July 2003. A loss is transferred from subsidiary member BCo to head company SmallHC when Small Group consolidates. The transfer occurs because the SBT is satisfied.

On 26 February 2004 another consolidated group, Big Group, acquires Small Group. This results in a COT failure for SmallHC.

This sequence of events is shown in figures 1–3.

¹ Losses transferred to a head company are deemed by subsection 707-140(1) to be made for the income year in which the transfer occurs. As the consolidation regime began on 1 July 2002, all losses transferred to a head company are losses made in an income year that starts after 30 June 1999.

Figure 1: Small Group consolidates

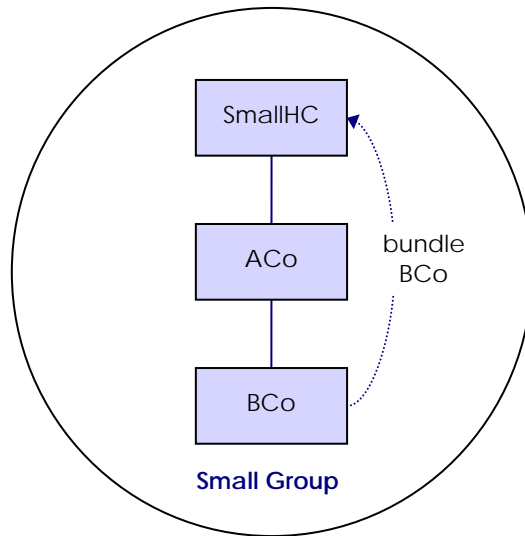


Figure 2: Big Group acquires Small Group

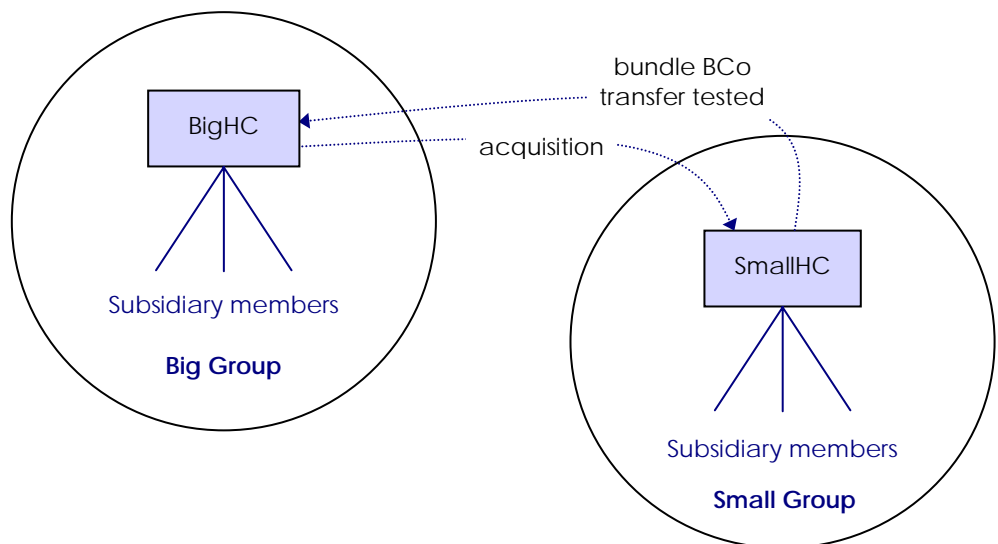
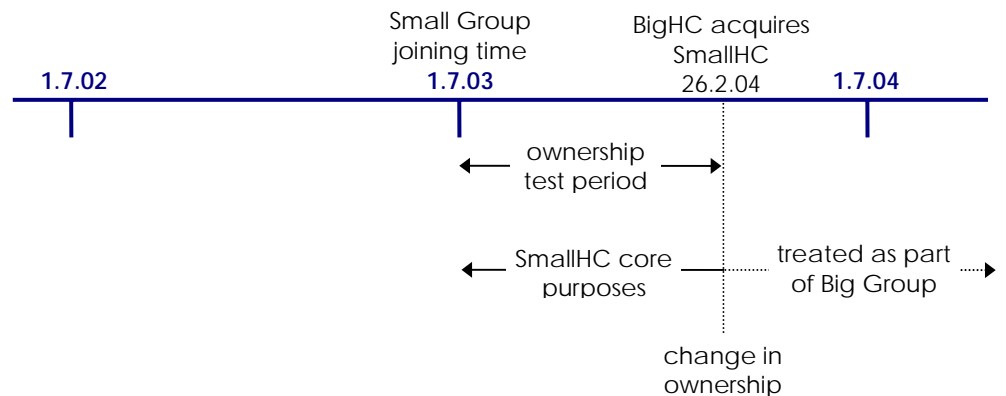


Figure 3: Joining entity (SmallHC) timeline



Step 1: Establish the unutilised carry-forward loss in bundle BCo at 26.2.04

To establish the amount of the loss in bundle BCo on hand at the joining time, SmallHC must bring to account any utilisation of the loss in working out its taxable income for the non-membership period 1 July 2003 to 25 February 2004².

Subsection 701-30(3A) provides that, for the purposes of determining if SmallHC can utilise the loss in the non-membership period, the period is taken to include the joining time (i.e. the non-membership period is taken to end on 26 February 2004). → 'Utilising loss in non-membership period – non-membership period is taken to include the joining time', C3-3-105

SmallHC has not maintained majority ownership from 1 July 2003, the start of the loss year. It has therefore failed the COT.

SmallHC is able to utilise the transferred loss in the non-membership period only if it can satisfy the SBT. As SmallHC is determining whether it can utilise a loss the SBT that must be satisfied is the standard test outlined in section 165-13³.

Assume that SmallHC satisfies the SBT and that part of the loss is utilised by SmallHC in the non-membership period.

Step 2: Determine whether the loss in bundle BCo is transferred to BigHC

The unutilised portion of the loss in bundle BCo is the loss available for potential transfer to BigHC → section 707-115. It is this loss that is subject to the transfer testing process in section 707-120⁴. The trial year for transfer testing is 26 February 2003 to 26 February 2004.

Step 2(a): Identify the ownership or control failure

The ownership test period for transfer testing is 1 July 2003 (the start of the loss year⁵) to 26 February 2004 (the end of the trial year).

In this example there has been a COT failure on 26 February 2004. Accordingly, the loss cannot be utilised by SmallHC in the trial year unless the modified SBT in section 707-125 is satisfied.

→ For a discussion of the transfer testing process see 'Treatment of losses', C3-1.

² Subsection 707-140(2) ensures SmallHC is not prevented from utilising the transferred loss in bundle BCo in the year of transfer.

³ For the purpose of applying the SBT in regard to a non-membership period, subsection 701-30(3A) assumes that the business conducted just after the end of the non-membership period is the same as the business conducted just before that time. Therefore, only the business of Small Group is considered.

⁴ Note that the loss is a loss made in the non-membership period as it was taken to be made by SmallHC in the year of transfer.

⁵ Subsection 707-205(2) deems the loss year to start at the time of transfer.

Step 2(b): Identify the modified SBT points

To work out whether the loss is transferred to BigHC, SmallHC is required to satisfy the SBT for:

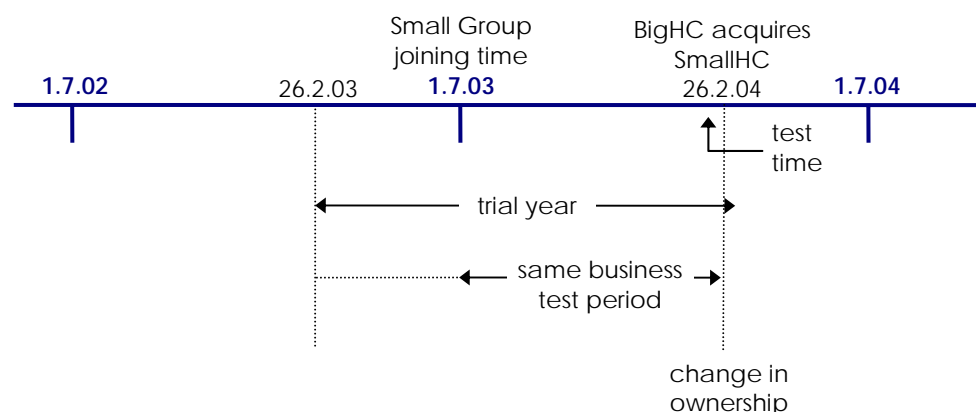
- the SBT period consisting of:
 - the trial year, and
 - the income year that included the test time that would normally apply for the SBT⁶ (the ‘change year’), if that income year started before the trial year, and
- the test time, being the time just before the end of the income year for which the loss was made by the company.

The change year does not begin before the trial year and therefore the SBT period consists only of the trial year.

The SBT period would normally consist of the single, continuous period 26 February 2003 to just after 26 February 2004⁷. This test would be unlikely to be satisfied, given the business of SmallHC as a head company would be compared to the business of SmallHC as a single entity. For this reason, section 707-400 ensures that the SBT period starts at the time SmallHC became a head company (1 July 2003).

The test time is just before the end of the non-membership period.

Figure 4: Modified SBT points



⁶ Section 165-13.

⁷ Subsection 707-120(3) assumes that the entity carried on the same business just after the joining time as it was carrying on just before that time. This effectively shortens the SBT period to end just before the joining time.

Step 3: Apply the SBT

SmallHC now applies the section 165-210 SBT in respect of the identified test times to determine whether the loss in bundle BCo transfers to BigHC⁸.

Subsequent utilisation of the transferred loss by BigHC

If the testing process concludes that the SBT is met at the relevant times, the loss transfers to the head company. As the loss in bundle BCo is being transferred for a second time, the available fraction that applies for that bundle must be adjusted, in accordance with item 1 in the table in subsection 707-320(2). The adjustment recognises that the available fraction should reflect the new income generating structure of Big Group. → 'Adjusting available fraction – previously transferred losses are transferred again', C3-4-310

The loss transfers to BigHC on 26 February 2004, which is part-way through its 2004 income year. Utilisation of the loss in bundle BCo for the 2004 income year must therefore be apportioned in accordance with section 707-335. Apportionment recognises that the loss has only been 'owned' by BigHC for part of the income year. → 'Apportioning the use of transferred losses', C3-4-610

References

Income Tax Assessment Act 1997:

- sections 165-12, 165-13, 165-210
- subsection 701-30(3A)
- sections 707-115, 707-120, 707-125, 707-140, 707-150
- subsections 707-205(2), 707-320(2)
- sections 707-335, 707-400

Revision history

Section C3-3-246 first published 10 December 2004.

Further revisions are described below.

Date	Amendment	Reason
27.1.05	Add figure 1 and amend text to clarify example.	Clarification.

Proposed changes to consolidation

Proposed changes to consolidation announced by the Government are not incorporated into the *Consolidation reference manual* until they become law. In the interim, information about such changes can be viewed at:

- <http://assistant.treasurer.gov.au> (Assistant Treasurer's press releases)
- www.treasury.gov.au (Treasury papers on refinements to the consolidation regime).

⁸ If the test is not met, the loss is not transferred and, pursuant to section 707-150, the loss cannot be subsequently utilised by any entity for income years ending after 26 February 2004.