Worked example

Group waiver rule – disregarding reductions to modified market value caused by intragroup injections of capital

Description

An integrity rule prevents the inflation of modified market value in respect of an injection of capital between members of a consolidated group. As illustrated in this example, the group waiver rule[1] ignores the effect of this integrity rule.

Note

For more information about:

- the integrity rule → 'Calculating an available fraction – losses transferred for the first time where there has been a pre-joining injection of capital', C3-4-120
- applying the value donor concession → 'Adding to modified market value to reflect loss transferability', C3-4-210
- the single waiver rule → 'Single waiver rule – disregarding a reduction to modified market value caused by an injection of capital from a value donor', C3-4-270

Commentary

The group waiver rule is only relevant when applying the value donor concession[2].

Broadly, the value donor concession enables the available fraction for a bundle of losses to be increased if the value donor could have received a loss from the real loss-maker under the wholly-owned company group loss transfer rules in Division 170 of the *Income Tax Assessment Act 1997* (ITAA 1997).

The increase to an available fraction provided by the value donor concession can be affected by the integrity rule. The integrity rule operates to reduce the modified market value of the entity (whether a real loss-maker or value donor) whose value was increased as a result of an event. The reduction amount essentially represents the increase in the value of the entity as a consequence of injections of capital[3] or non-arm's length transactions involving the entity in the four years[4] before it joins the consolidated group. → subsections 707-325(2) to (5), ITAA 1997

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[1] Section 707-328A, *Income Tax (Transitional Provisions) Act 1997* (IT(TP)A).

[2] The value donor concession is contained in Subdivision 707-C, IT(TP)A.

[3] Taxation Ruling 2004/9 provides the ATO view on the meaning of the expression 'injection of capital'.

[4] The integrity rule does not apply to events that occur before 9 December 2000.

In certain circumstances it is appropriate to 'waive' the consequences of inflationary events occurring within the wholly-owned group. In working out an available fraction for the real loss-maker's bundle of losses, the group waiver rule ignores the effect of the integrity rule in respect of the following events:

- a pre-consolidation injection of capital into a group member by another group member, and
- a non-arm's length transaction involving only group members.

The group waiver rule applies only if all other group members donate their value and losses to the real loss-maker under the value donor concession. The head company must choose to apply the group waiver rule in respect of a single group member that transferred losses to the head company on group formation under Subdivision 707-A of the ITAA 1997. This choice must be made by the later of:

- the end of 31 December 2005, and
- the day it lodges its income tax return for the first income year for which it utilises transferred losses using the available fraction method.

  → subsection 707-328A(4), (IT(TP)A)

The group waiver rule can be applied only if the following conditions are met:

- all members of the group at the formation time are companies
- the choice is made for the value donor concession to apply whereby value is donated to the real loss-maker from every other group member
- the head company chooses to treat any losses transferred to it on formation by the value donors as if they were included in the real loss-maker's bundle, and
- none of the group members have had their modified market value reduced because of an injection of capital or a non-arm's length transaction involving an entity that did not become a member of the group on formation.

If all the conditions are met, all of the group's transferred losses[5] are utilised with reference to the chosen real loss-maker's available fraction. That fraction is worked out on the basis of the real loss-maker's modified market value plus the modified market value of all other group members.

Where the conditions are not met, the single waiver rule, which looks individually at each real loss-maker and value donor relationship within the group, may be able to be applied.

→ section 707-326, IT(TP)A; 'Single waiver rule – disregarding a reduction to modified market value caused by an injection of capital from a value donor', C3-4-270

[5] Excluding overall foreign losses, whose utilisation is not affected by the value donor concession.

Example

Facts

HCo and its subsidiaries ACo and BCo have constituted a wholly-owned group for a number of years. On 1 July 2003, HCo chooses to form a consolidated group.

On formation ACo and BCo transfer tax losses to HCo. HCo and ACo are able to donate value to BCo (the real loss-maker) for the purpose of determining the available fraction for BCo's bundle of losses. ACo's transferred losses meet the conditions for them to be utilised as though they are included in BCo's bundle.

Prior to formation HCo injected capital of $100 into each of ACo and BCo.

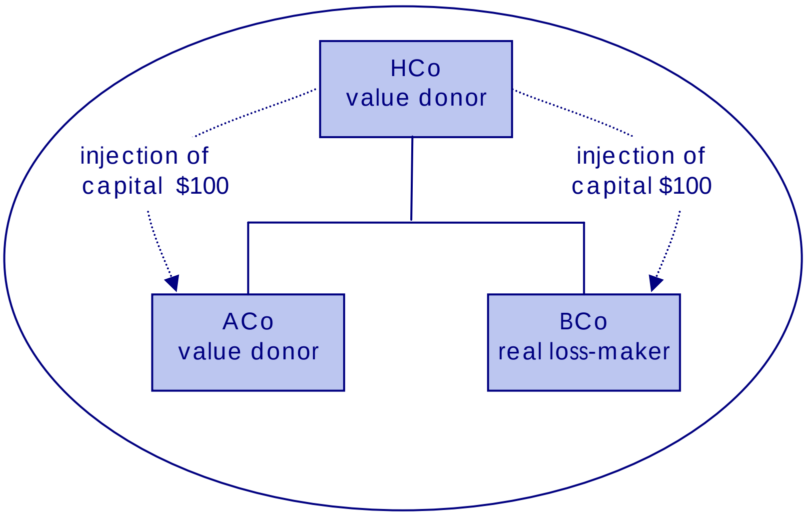
Assume for the purposes of subsection 707-325(3) of the ITAA 1997 that the reduction amount equals the amount of each injection of capital.

HCo, ACo and BCo satisfy all the requirements in relation to the value donor concession.

HCo chooses 100% of the modified market values of HCo and ACo to be donated for the purposes of working out the available fraction for BCo's bundle of losses.

These facts are represented in figure 1.

Figure 1: HCo and subsidiary members



The adjusted market value of the consolidated group at the initial transfer time is $1,200.

Modified market values ascertained as at the joining time are shown in table 1.

Table 1: Modified market values at 1 July 2003

Entity	Modified market value (subsection 707-325(1), ITAA 1997)	'Reduced' modified market value (subsection 707-325(2), ITAA 1997)
HCo	$800	$800*
ACo	$100	nil
BCo	$300	$200

* The integrity rule does not apply in respect of HCo.

Calculation

Applying the value donor concession, ignoring the application of the group waiver rule, the available fraction for BCo's bundle of losses would be:

$$\frac{200 + \text{nil} + 800}{1{,}200} = 0.833$$

Application of the group waiver rule

The group waiver rule can be applied because the only injections are entirely intragroup. This means the modified market values of ACo and BCo are worked out disregarding the effect of subsection 707-325(2) of the ITAA 1997 in respect of the injections of capital from HCo → subsection 707-328A(3), IT(TP)A. The modified market value of ACo can therefore include the $100 of value injected by HCo, and the modified market value of BCo can include the $100 of value injected by HCo.

Applying the value donor concession, including the application of the group waiver rule, the available fraction for BCo's bundle of losses would be:

$$\frac{300 + 100 + 800}{1{,}200} = 1.000$$

References

Income Tax Assessment Act 1997, sections 707-320, 707-325

Income Tax (Transitional Provisions) Act 1997, Subdivision 707-C; as amended by *Tax Laws Amendment (2005 Measures No. 5) Act 2005* (162 of 2005), Schedule 3, Part 2

Revision history

Section C3-4-260 first published 27 January 2005. Further revisions are described below.

Date	Amendment	Reason
12.9.06	Extension of time to revoke election to apply group waiver rule, p. 2.	Legislative amendment.

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).