

Application of the loss reduction method to consolidated and MEC groups

The loss reduction method (LRM) applies to consolidated and multiple entry consolidated (MEC) groups because it is not feasible to require such groups to determine the effect on market values of losses or value shifts involving group members.

Broadly, the LRM applies to deny most losses realised on certain direct and indirect equity or loan interests in members of consolidated and MEC groups – the loss integrity measures (LIM) and the general value shifting regime (GVSR) do not apply to these interests.

→ 'General value shifting regime (GVSR)', C2-6-170

Coverage of the LRM

An entity's direct or indirect equity or loan interests in a member of a consolidated or MEC group is only covered by the LRM when the entity, during the period it owned the interest:

- was head company of the group
- was an associate of the head company
- controlled the head company (for value shifting purposes), or
- was an associate of an entity that controlled the head company (for value shifting purposes).

Equity or loan interests are not covered by the LRM if they are:

- direct or indirect equity or loan interests in the head company of a consolidated group (except where the head company of a consolidated group is an eligible tier-1 company of a top company)
- equity interests that are pooled interests in relation to a MEC group
- direct or indirect equity or loan interests in the top company of a MEC group, or
- membership interests in, or liabilities owed by, an entity leaving the group.

Such interests are covered by the rules relating to ITAA 1997 Subdivision 165-CD, Division 727 or the consolidation rules (e.g. Division 711).

→ 'Effect of Subdivision 165-CD for consolidated groups', C2-6-130

→ 'Effect of Subdivision 165-CD for MEC groups', C2-6-150

→ 'Pooling of external membership interests', C10-2-420

→ 'An eligible tier-1 company leaving a MEC group', C10-2-430

→ 'Subdivision 165-CD widely held company concession for an eligible tier-1 company that is head company of a consolidated or MEC group', C2-6-155

→ subsection 715-610(2), ITAA 1997

Interests affected

Interests that can be affected by the LRM (when owned by a relevant entity) include:

- loan interests in a subsidiary member of a group or in an eligible tier-1 company of a MEC group
- equity or loan interests in an entity that itself has a loan interest in a subsidiary member or eligible tier-1 company
- direct and indirect equity or loan interests in entities with pooled interests in eligible tier-1 companies of a MEC group, as well as interests in entities interposed between such entities and the top company of the MEC group
- rights and options in subsidiary members of a consolidated or MEC group, and
- direct and indirect equity or loan interests in an interposed foreign resident entity (IFRE) that are related to a transitional foreign-held subsidiary member (TFHS) of the group.

The bold arrows in figures 1 and 2 show the interests to which the LRM applies.

Figure 1: Application of the LRM to a consolidated group

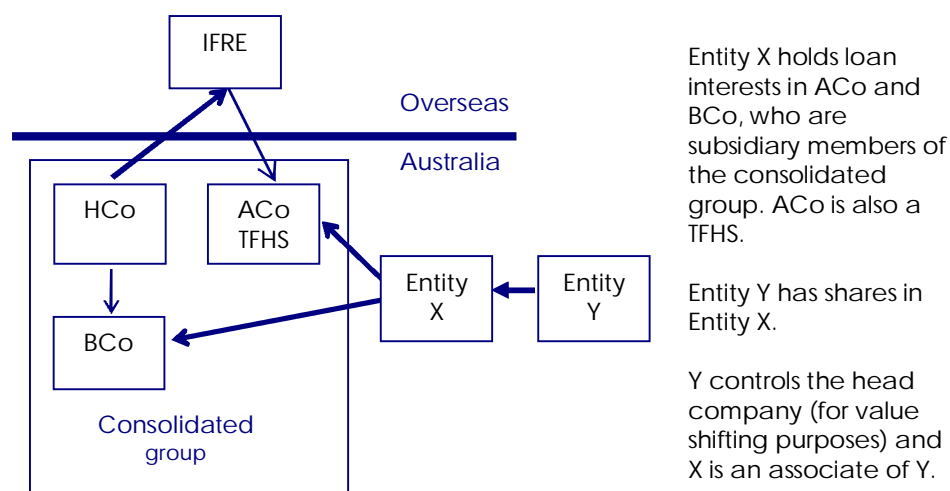
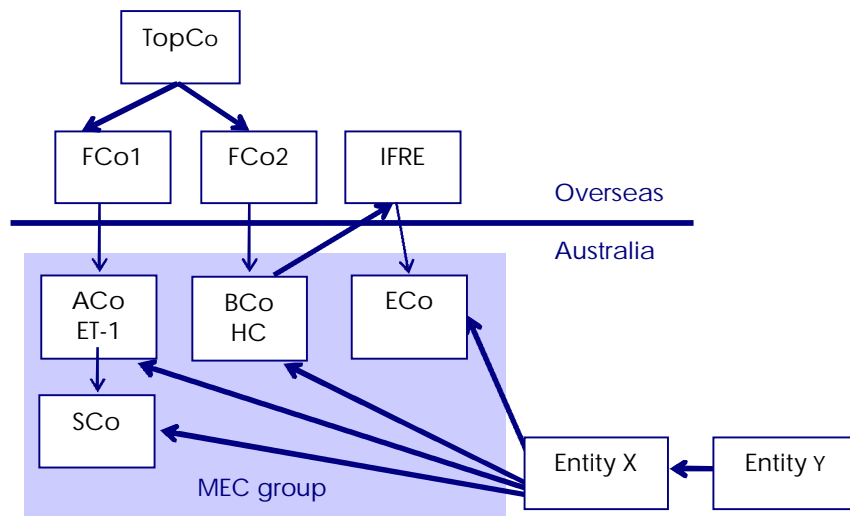


Figure 2: Application of the LRM to a MEC group



Entities X and Y hold direct and indirect loan interests in BCo, the head company of the MEC group, and in ACo, ECo and SCo, subsidiary members of the MEC group. X and Y control the head company (for value shifting purposes) or are associates of an entity that controls the head company.

References

Income Tax Assessment Act 1997, Subdivision 715-H and Subdivision 719-T; as amended by *New Business Tax System (Consolidation and Other Measures) Act 2003* (No. 16 of 2003), Schedule 7

Explanatory Memorandum to *New Business Tax System (Consolidation and Other Measures) Bill* (No. 2) 2002, Chapter 11

Income Tax Assessment Act 1997, Sections 727-355 and 727-520; as amended by *New Business Tax System (Consolidation, Value Shifting Demergers and Other Measures) Act 2002* (No. 90 of 2002), Schedule 15

Explanatory Memorandum to *New Business Tax System (Consolidation and Value Shifting, Demergers and Other Measures) Bill* (No. 2) 2002, Chapters 8 and 11

Income Tax Assessment Act 1997, Subdivision 715-H and subsections 165-115X, 165-115Y, 715-230, 715-255, 715-270 and 715-450; as amended by *Tax Laws Amendment (2010 Measures No. 1) Act 2010* (No. 56 of 2010) Schedule 5, Part 16

Explanatory Memorandum to the *Tax Laws Amendment (2010 Measures No. 1) Bill 2010*, Chapter 5, paragraphs 5.325 – 5.348

Supplementary Explanatory Memorandum to *Tax Laws Amendment (2010 Measures No. 1) Bill 2010*, Chapter 2, paragraphs 2.26 – 2.32

Revision history

Section C2-6-160 first published 28 May 2003.

Further revisions are described below.

Date	Amendment	Reason
27.10.03	Amend format of figure 2 – LRM does not apply to IFRE's interests in ECo.	Formatting error.
6.5.11	New reference to case where head company is an eligible tier-1 company, p. 1.	Legislative amendment.