

Worked example

Acquisition of part of a MEC group – transfer of losses to newly formed consolidated group

- Description** This example shows how the losses of a multiple entry consolidated (MEC) group may be transferred to a consolidated group in a situation where:
- the provisional head company of the MEC group is acquired by a resident company
 - the MEC group ceases to exist as the remaining eligible tier-1 companies do not make a written choice to appoint a replacement provisional head company → subsection 719-60(3), and
 - the consolidatable group comprising the resident company and the former head company of the MEC group make a choice in writing to form a consolidated group immediately → section 703-50.

Note

For more information about:

- MEC groups and their members → 'Multiple entry consolidated (MEC) groups', C10-1
- provisional head company rules → 'Provisional head company', C10-2-130
- transfer of losses → 'Treatment of losses', C3-1 and worked examples C3-3-210 to C3-3-270
- determining whether the head company (or former head company) of a MEC group satisfies the continuity of ownership test → worked examples C10-2-325 to C10-2-392
- making a choice in writing → 'Choice in writing', C7-1-110

Commentary

Cessation of a MEC group

Where the provisional head company of a MEC group ceases to be an eligible tier-1 company of the top company, a cessation event (→ subsection 719-60(6)) happens to the provisional head company as it ceases to meet the requirements to be the provisional head company of the MEC group → section 719-65. This would occur, for example, where the provisional head company is acquired by a resident company.

Where a cessation event happens to the provisional head company of a MEC group, the remaining eligible tier-1 companies may make a choice in writing to jointly appoint one of those companies to be the new provisional head company. The appointment is taken to be effective immediately after the cessation event.

Failure to appoint a replacement provisional head company results in the cessation of the MEC group → paragraph 719-5(7)(c). It is taken to have ceased to exist at the time there ceases to be a provisional head company.

The provisional head company is taken to be the head company of the MEC group for the period in the income year ending just before the cessation of the MEC group → subsection 719-75(3).

Formation of a consolidated group

The head company of a consolidatable group can make a choice in writing under section 703-50 to form a consolidated group from the date specified in the choice. Notification of the choice must be given to the Commissioner in the approved form within the period specified in subsection 703-58(2).

The group is taken to be consolidated on and after the date specified in the written choice. If a consolidatable group comes into existence on a particular day, because an entity becomes beneficially owned on that day (or is taken to become beneficially owned at that time under section 703-33), a consolidated group can be formed beginning from that day.¹

Therefore, if a cessation event happening to a provisional head company of a MEC group results in the creation of a consolidatable group that includes the former provisional head company, it is possible for that latter group to immediately form a consolidated group. This means the former head company would go directly from being a member of the MEC group to being a member of the consolidated group without there being any period in which it is a stand-alone entity.

Transfer of losses to consolidated group

Under subsection 707-120(1), a loss is transferred to the head company of a consolidated group at the joining time if the loss could have been utilised by the joining entity in the trial year. The trial year generally begins 12 months before the joining time and ends just after the joining time.

Where the joining entity is a company, the transfer of a loss requires either the continuity of ownership test (COT) or the same business test (SBT) to be satisfied. These tests are modified in Subdivision 707-A so that they apply appropriately in a transfer testing context.

In addition, Subdivision 719-F modifies the rules for the transfer and utilisation of losses in relation to MEC groups. For example, the company seeking to utilise or transfer the loss will be taken to have satisfied the COT if the company identified as the test company (→ section 719-265) is taken to have satisfied the COT based on certain assumptions → sections 719-270, 719-275 and 719-280.

Where a cessation event happens to a provisional head company and the MEC group ceases to exist because of failure to appoint a replacement provisional

¹ In some circumstances, a consolidated group can come into existence at some time during a day. → Taxation Determination TD 2006/74

head company, any losses of the MEC group are retained by the former head company.

If all the membership interests in the former head company are acquired by a resident company that immediately forms a consolidated group, there is no period that the former head company exists as a stand-alone entity prior to joining the consolidated group. The consequences for the losses held by the former head company are as follows:

- Transfer tests need to be satisfied by the former head company before the losses can be transferred to the head company of the consolidated group.
- The test company for each loss is deemed to have failed the COT at the joining time as a result of the cessation of the MEC group → subsection 719-280(4). The former head company is taken to have failed the COT for these losses at this time (assuming it had not failed the COT at an earlier time → subsection 719-260(2)).
- The modified SBT in section 707-125 needs to be satisfied by the former head company for the losses to be transferred.

The single entity rule and the SBT

The single entity rule in section 701-1 applies when examining the business of the former head company for the period that it was the head company of the MEC group. Under this rule, subsidiary members are taken to be part of the head company. This means the business of the head company consists of one overall business that includes all the activities conducted by subsidiary members of the group.

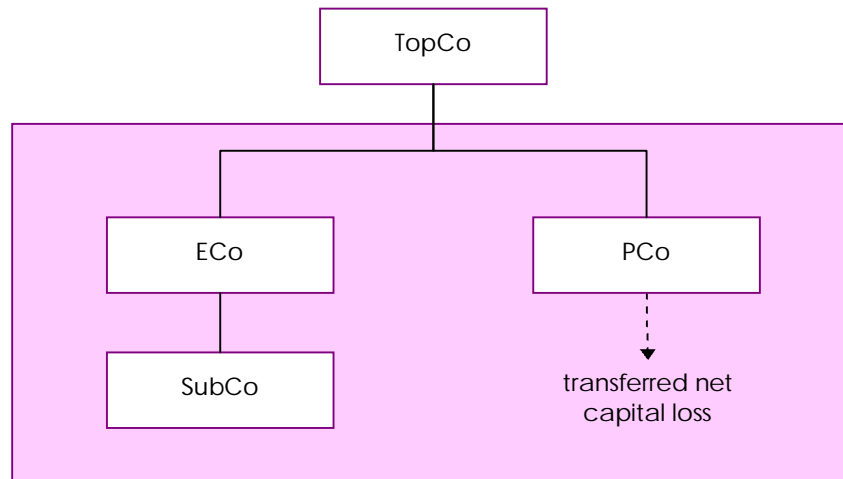
Subsection 707-120(3) provides that the business of the former head company at and just after the joining time is the business it carried on just before the joining time. This means the SBT period effectively ends just before the joining time.

Provided the former head company's business at the relevant testing times is unchanged, losses it holds may be transferred to the head company of the consolidated group.

Example

Facts PCo, ECo and SubCo, which are wholly owned by the non-resident company TopCo, form a MEC group on 1 July 2003 with PCo as the provisional head company (figure 1). At formation, losses are transferred from ECo and SubCo to PCo. A group loss is incurred in the year ended 30 June 2004.

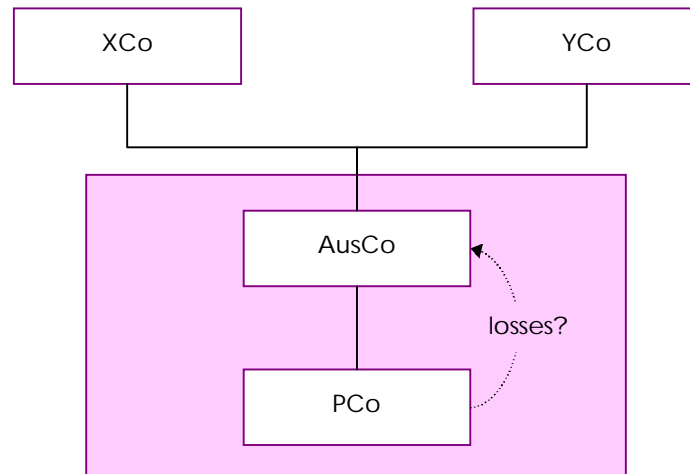
Figure 1: The PCo MEC group (1 July 2003 to 30 June 2004)



AusCo, a resident company, acquires 100% of the shares in PCo (figure 2). This is the only ownership change that has impacted on the MEC group since its formation. The change in beneficial ownership of the shares, for the purposes of the consolidation membership rules, occurs at the start of 1 July 2004. At that time, AusCo and PCo become a consolidatable group. AusCo makes a valid choice in writing to form a consolidated group with effect from 1 July 2004. The consolidated group comes into existence at the start of that day.

ECo, the remaining eligible tier-1 company of the MEC group, does not make a choice in writing to appoint itself as the provisional head company. The MEC group therefore ceases to exist from 1 July 2004 and losses remain with PCo for potential transfer to AusCo as head company of the consolidated group.

Figure 2: The AusCo consolidated group (1 July 2004)



Calculation Loss transfer test

Subdivision 707-A determines whether the losses held by PCo are transferred to AusCo at the joining time. The losses will be transferred under section 707-120 if PCo could have utilised the losses in the trial year. The trial year in this case is from 1 July 2003 to just after the joining time on 1 July 2004.

The cessation of the MEC group, as a result of the change in beneficial ownership of PCo at the joining time on 1 July 2004, means the relevant test company for each loss is deemed to have failed the COT. Therefore PCo fails the COT at this time for each loss. The losses held by PCo can only transfer to AusCo if the modified SBT in section 707-125 is satisfied.

The SBT must be satisfied where:

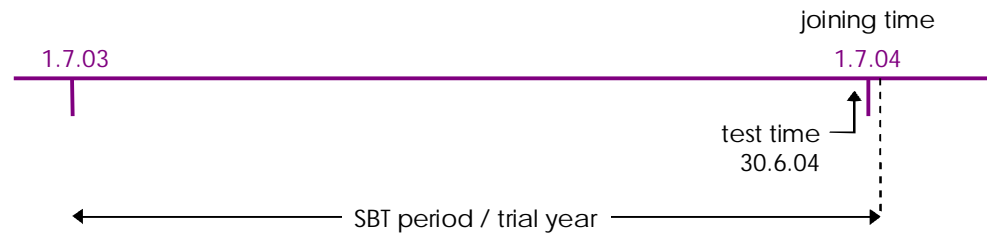
- the SBT period is the trial year,² and
- the test time is just before the end of the income year ended 30 June 2004, that is, the year that both the transferred losses and the group loss are made.³

Figure 3 illustrates the testing points for PCo.

² The SBT period also includes the income year that included the test time worked out under section 165-13 if that income year started before the trial year. In this case, this income year does not start before the trial year.

³ The losses transferred to PCo on 1 July 2003 are taken to be made in the income year in which they were transferred – subsection 707-140(1).

Figure 3: The same business test points



The business carried on by PCo on and just after the joining time is taken to be the business it carried on just before the joining time. Therefore the business of PCo is examined only in that part of the trial year to just before the joining time. In that period, PCo is always the head company of the MEC group and, pursuant to the single entity rule, the business of the entire MEC group (comprising PCo, ECo and SubCo) is examined.

Similarly, the test time is just before the end of the income year ended 30 June 2004, which again is a time when PCo is the head company of the MEC group and its business is the business of the entire MEC group.

If the business of the MEC group for these testing times has remained unchanged, the modified SBT in section 707-125 can be satisfied and the losses held by PCo are able to transfer to AusCo.

References

Income Tax Assessment Act 1997:

- sections 165-13, 701-1, 703-33, 707-120, 707-125, 707-140
- subsections 719-5(7), 719-60(6)
- subsections 719-75(3), 719-260(2)
- sections 719-265, 719-270, 719-275, 719-280
- section 703-50, as amended by *Tax Laws Amendment (2010 Measures No. 1) Act 2010* (No. 56 of 2010), Schedule 5, Part 18
- section 719-65, as amended by *Tax Laws Amendment (2010 Measures No. 1) Act 2010* (No. 56 of 2010), Schedule 5, Part 2
- subsections 703-58(2), 719-60(3), as amended by *Tax Laws Amendment (2010 Measures No. 1) Act 2010* (No. 56 of 2010), Schedule 5, Part 18

Tax Laws Amendment (2010 Measures No. 1) Act 2010, Parts 2 and 18

Explanatory Memorandum to the Tax Laws Amendment (2010 Measures No. 1) Bill 2010, paragraphs 5.101 to 5.104, 5.369 to 5.373 and 5.418 to 5.421

Taxation Determination TD 2006/74

Revision history

Section C10-2-395 first published 26 June 2007.

Further revisions are described below.

Date	Amendment	Reason
6.5.11	Revisions to reflect changes to the choice and notification provisions.	Legislative amendments.