Transferring and using losses

Key points

In general:

- Unused carry-forward losses of a joining entity can be transferred to the head company of a consolidated group if the losses could have been used by the joining entity.
- Transferred losses can be utilised by the head company at approximately the same rate that would have been available to the joining entity had it remained outside the group.
- A concessional method is available that allows for certain transferred losses to be utilised over three years.

Transferring losses

When an entity joins a consolidated group, it calculates its taxable income or loss for the period up to the time it joins the group. Generally, any unused carry-forward losses are transferred to the head company if the losses *could* have been used by the joining entity in the 12 months prior to joining the consolidated group. This is known as the 'trial year' and extends to just after the joining time.

Whether the losses could have been used by the joining entity in the trial year is determined by applying modified versions of the usual tests for deducting and applying losses:

- **continuity of ownership test:** requires that the joining entity maintained a majority of the same ownership for the period between incurring the loss and just after the joining time (the joining entity must also satisfy the control test)

  or, if the continuity of ownership or control test is not met:

- **same business test:** requires that the joining entity carry on the same business for at least the 12 months prior to the joining time.

If the joining entity subsequently ceases to be a member of the consolidated group, all losses remain with the head company.

→ 'Treatment of losses', C3-1

Note

Removal of existing grouping provisions

After 30 June 2003 (this date varies if the head company has a substituted accounting period), an unconsolidated group will not be able to offset losses in subsidiaries with other wholly-owned group members. These losses would need to be offset against the income or gains generated by the individual group member. By choosing to consolidate, these tax attributes will be able to be used by the group (subject to the transfer rules, recoupment rules and the prescribed utilisation rate).

→ 'Choosing', B1-1

Using losses

Losses utilised by the head company can be either:

- losses generated by the group (group losses), and/or
- transferred losses that were generated by an entity before it became a member of the group.

Group losses must be utilised before transferred losses. Before utilising either a group loss or transferred loss, the head company must apply the general loss recoupment provisions – that is, it must pass either the continuity of ownership and control tests or the same business test. For transferred losses, these tests are modified for the purposes of determining whether the company has maintained the same ownership:

- the loss year is modified so that it starts from when the loss was transferred to the head company (this ensures that things that happened to the head company before the transfer time are not taken into account in applying the continuity of ownership test)
- for a loss transferred to the head company from a company as a result of passing the continuity of ownership and control tests, pre-consolidation ownership changes in the loss company are recognised.

Determining the amount of transferred losses that can be utilised

There are two methods of determining the amount of transferred losses that can be utilised:

- available fraction method
- concessional method.

Available fraction method

The use of transferred losses is limited by their available fraction. The available fraction is a proxy for determining the proportion of the group's income or gains generated by the loss entity against which the losses may be utilised.

The available fraction is calculated for a 'loss bundle'. A loss bundle is a set of losses transferred to the head company from the same joining entity at the same time. Losses within a loss bundle are categorised by sort (such as film losses and net capital losses).

The available fraction for each bundle of losses is calculated as follows:

$$\frac{\text{Modified market value of the loss entity}}{\text{Adjusted market value of the consolidated group}}$$

To use this method, market valuations for both the loss entity and the consolidated group are necessary.

There is a limit on the amount of losses of each sort within a bundle of losses that can be utilised by the head company. Broadly, the limit is set by multiplying the head company's income or gains of that type by the available fraction for the bundle of transferred losses.

Transferred losses that cannot be used in a given year can be carried forward.

As a concession for groups that consolidate during the transitional period – that is, between 1 July 2002 and 30 June 2004 – the head company, in certain circumstances, can increase the available fraction for a bundle of losses transferred from a member company (essentially by transferring part of the modified market value of another group company to the loss company).

Concessional method

The head company has the option of using losses over the three years following consolidation, subject to some limits. This method is only available:

- for losses that were transferred as a result of passing the continuity of ownership and control tests, and were actually incurred in an income year ending on or before 21 September 1999
- if the group consolidates during the transitional period – that is, between 1 July 2002 and 30 June 2004 – and the member (that is a company) transfers its losses at that consolidation date.

When determining the amount of losses utilised in an income year, losses claimed on a concessional basis are generally utilised before other transferred losses of the same sort.

More information

→ 'Treatment of losses', C3-1