Worked example

Adjusting available fraction – transferred losses and group losses are transferred at the same time

Description   Available fractions are adjusted to ensure they continue to approximate the proportion of the group's income that can be said to be generated by the relevant entity or group that transferred the loss.

This example shows how the available fractions for loss bundles are adjusted when both group losses and previously transferred losses are transferred to another consolidated group.

> **Note**
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> For more information about:
>
> - loss bundles and calculating the available fraction → 'Treatment of losses', C3-1; 'Consolidation loss provisions', C3-2-110 (high-level worked example)
>
> - working out modified market value → 'Modified market value of a single joining entity', C3-4-110 (worked example)

Commentary   If the head company of a consolidated group (the old group) joins another consolidated group (the new group), unrecouped losses of the old group are transferred to the head company of the new group (if the relevant transfer tests are met). If these transferred losses comprise both previously transferred losses and group losses (i.e. losses generated by the consolidated group), the available fraction for each transferred loss bundle must be adjusted under item 2 in the table in subsection 707-320(2).

The available fraction for each bundle being transferred from the old group is adjusted by multiplying it by the following factor:

$$\frac{\text{the lesser of the available fraction for group losses and 1}}{\text{the total of available fractions for all bundles being transferred}}$$

This factor caps the total of the available fractions for incoming bundles so that their sum does not exceed what would have been the available fraction for the group loss bundle. This adjustment ensures available fractions bear the correct proportion to each other and ensures that any adjustment required under item 3 is applied correctly.

If there are previously transferred losses in the new group, adjustments are also required under item 3 in the table in subsection 707-320(2). In this case, there is essentially a 4-step calculation process[1]:

- Step 1: The available fraction for the bundle of group losses needs to be established. The available fraction for a bundle of losses being transferred for the first time is calculated under subsection 707-320(1).

- Step 2: The available fraction for each of the old group's previously transferred bundles now being transferred to the new group is adjusted under item 1 in the table in subsection 707-320(2).

  → For an example of this adjustment see 'Adjusting available fraction – previously transferred losses are transferred again', C3-4-310

- Step 3: The available fraction for each incoming bundle is adjusted under item 2 in the table in subsection 707-320(2).

- Step 4: The available fraction for each bundle of the previously transferred losses still held by the new group is adjusted under item 3 in the table in subsection 707-320(2). → For an example of this adjustment see 'Adjusting available fraction – another loss entity joins the group', C3-4-330

Example

Facts   A consolidatable group, 'Old Group', consolidates on 1 July 2003. A loss made by subsidiary member BCo is transferred to OldHC, the head company of Old Group, when the group consolidates. An available fraction of 0.875 is established for bundle BCo at the initial transfer time.

Another consolidated group, 'Big Group', consists of head company BigHC and subsidiary member ACo. A loss made by ACo is transferred to BigHC when ACo joins the consolidated group. An available fraction of 0.386 is established for bundle ACo at the initial transfer time.

Big Group acquires Old Group on 1 July 2004.

When OldHC joins Big Group, the loss in bundle BCo and a group loss incurred for the 2004 income year are transferred to BigHC, which then has three loss bundles:

- bundle ACo
- bundle BCo
- bundle OldGroup (containing the group loss originally made by Old Group).

This sequence of events is shown in figure 1. Big Group must establish an available fraction for bundle OldGroup and adjust all available fractions by the relevant item in the adjustment table.

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[1] Subsection 707-320(3) ensures that calculations are made in the order they appear in the table. Results of an adjustment made under an earlier item are used in making a calculation under a later item.

Figure 1: Big Group acquires Old Group
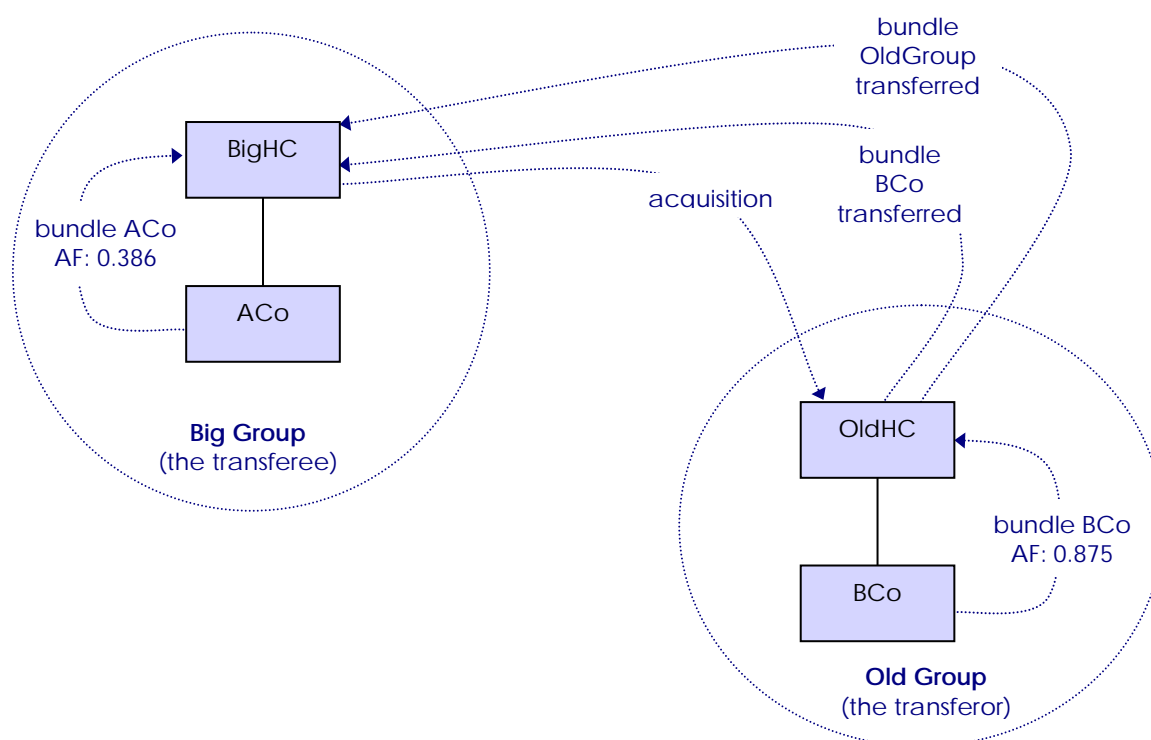
Market values are ascertained as at the time of Old Group joining (1 July 2004) as follows:

- market value of Old Group   = $500
- market value of the new joined group   = $1,500
  (including the market value
  of Old Group)

Calculation   **Step 1** – Establish the available fraction for bundle OldGroup (assuming the modified market value of the transferor equals the market value of Old Group and the adjusted market value of the transferee equals the market value of the new joined group):

$$\frac{500}{1,500} \ = \ 0.333$$

Step 2 – Apply adjustment item 1 to the available fraction for bundle BCo by multiplying it by the relevant factor:

$$0.875 \quad \times \quad \frac{500}{1,500} \ = \ 0.292$$

The sum of the available fractions for the bundles being transferred is 0.625 (0.333 + 0.292). This figure will be the denominator of the item 2 factor.

Step 3 – Apply adjustment item 2 to the available fractions for bundles OldGroup and BCo by multiplying each by the item 2 factor:

$$\text{OldGroup:} \quad 0.333 \quad \text{x} \quad \frac{0.333}{0.625} \quad = \quad 0.177$$

$$\text{BCo:} \quad 0.292 \quad \text{x} \quad \frac{0.333}{0.625} \quad = \quad 0.156$$

The sum of the available fractions for new bundles that have been transferred is 0.333 (0.177 + 0.156). This corresponds with the available fraction initially calculated for bundle OldGroup. This figure will be inserted into the item 3 factor.
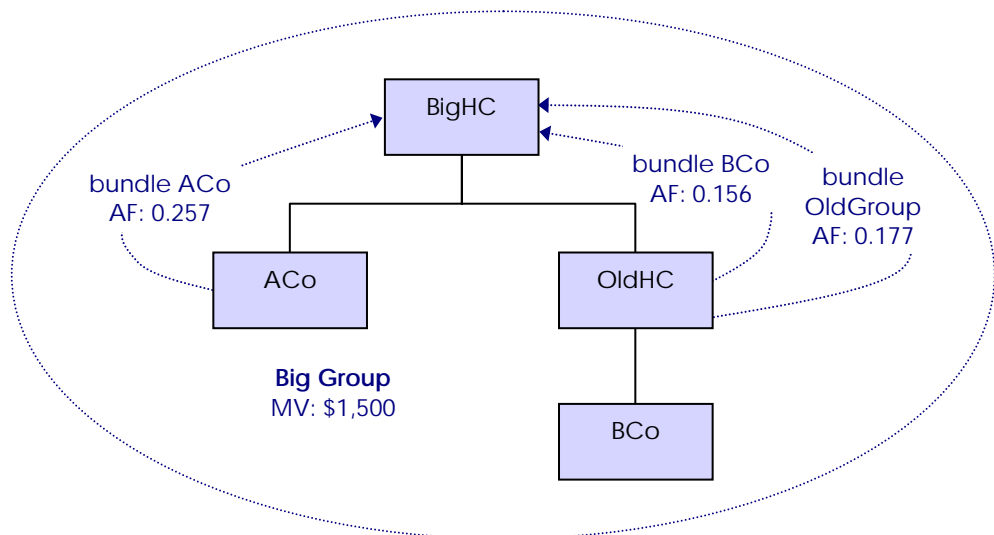
Step 4 – Apply adjustment item 3 to the available fraction for bundle ACo by multiplying it by the item 3 factor:

$$\text{ACo:} \quad 0.386 \quad \text{x} \quad [\,1 - 0.333\,] = \quad 0.257$$

The utilisation of losses in each bundle is subject to limits determined by reference to the available fraction method.

The new consolidated structure just after the transfer time is shown in figure 2.

Figure 2: The new joined group

References *Income Tax Assessment Act 1997*, subsections 707-320(1), 707-320(2), 707-320(3); as amended by *New Business Tax System (Consolidation) Act (No.1) 2002* (No. 68 of 2002), Schedule 1

Explanatory Memorandum to the New Business Tax System (Consolidation) Bill (No. 1) 2002, Chapter 8