

Worked example

Losses transferred from members that are in liquidation can be used as basis for value and loss donation

- Description** This example shows that:
- losses incurred by companies in liquidation (liquidation members) when joining a consolidated group on its formation may be transferred to the head company if the requirements in Subdivision 707-A of the *Income Tax Assessment Act 1997* (ITAA 1997) are satisfied
 - liquidation members can be value donors and other members can be value donors to them under section 707-325 of the *Income Tax (Transitional Provisions) Act 1997* (IT(TP)A 1997)
 - the head company can choose to treat losses transferred from a liquidation member as if they were included in another bundle of losses under section 707-327 of the IT(TP)A 1997.

Note

For more information about:

- the value and loss donor concession → examples C3-4-210 to C3-4-255
- the impact of liquidation on a company's ability to be a member of a consolidated group → 'Impact of liquidation and deregistration', C7-1-220.

Commentary

Transfer of losses incurred by subsidiary company in liquidation

Subdivision 707-A of the ITAA 1997 contains the rules for the transfer of a loss to the head company of a consolidated group. For a loss to be transferred it needs to pass modified versions of the loss recoupment tests. A loss can only be transferred to the extent that it could have been utilised by the joining entity in the trial year. In the context of companies, the relevant recoupment tests are contained in Division 165 of the ITAA 1997 and include the continuity of ownership and control tests, and the same business test as an alternative.

→ 'Treatment of losses', C3-1

Amendments¹ have been made to Division 165 to expressly provide that the appointment of a liquidator or other external administrator to a company does not of itself have an impact on:

- whether the company satisfies the continuity of ownership test, or
- whether shares or interests in shares that it holds can be taken into account in determining whether another company satisfies the continuity of ownership test.

¹ *Tax Laws Amendment (Loss Recoupment Rules and Other Measures) Act 2005*.

Broadly, the amendments provide that:

- the fact that a company becomes an externally administered body corporate does not prevent an entity from beneficially owning shares in the company or having control of voting power in the company, or having rights to dividends or capital distributions of the company
→ subsection 165-208(1), ITAA 1997
- the fact that a company becomes an externally administered body corporate does not prevent it beneficially owning shares in another company, controlling voting power in another company or having rights to dividends and capital distributions attaching to those shares
→ subsection 165-208(2), ITAA 1997.

The amendments also expressly provide that the appointment of an external administrator to a company does not affect the control of voting power in the company for the purposes of the test in section 165-15 of the ITAA 1997 (or equivalent tests in sections 165-40, 165-115D, 165-115M, and 165-129)

→ section 165-250, ITAA 1997.

The effect of these rules is that there is no impact on the continuity of ownership and control tests for the purpose of transfer testing if the joining entity, or a company interposed between it and an ultimate owner, becomes externally administered.

Value donor provisions and liquidation

Under section 707-325 of the IT(TP)A 1997, a head company may choose to add to the modified market value of a loss entity (the 'real loss-maker') the modified market value of another company (the 'value donor') when calculating the available fraction for the bundle of losses transferred from the real loss-maker. The value donor must be a company to which the real loss-maker could have transferred, under the group loss transfer rules in Subdivisions 170-A and 170-B² of the ITAA 1997, at least one of the losses³ in its bundle.

One of the conditions for transfer under Subdivisions 170-A and 170-B is that both companies (the loss company and the income company) must be members of the same wholly-owned group → sections 170-30 and 170-130, ITAA 1997. Broadly, this means there must be 100% common beneficial ownership of the two companies by another company (holding company) or one company is 100% beneficially owned by the other company (holding company) or its 100% subsidiaries → sections 975-500 and 975-505, ITAA 1997.

This 100% beneficial ownership requirement is not satisfied if a person can or would be able to affect the rights of the holding company in relation to the subsidiary company → section 975-150 and subsections 975-505(2) and (3), ITAA 1997.

² On the assumption that neither of those subdivisions had been amended to provide only for transfers involving an Australian branch of a foreign bank (subsection 707-328(4) of the IT(TP)A 1997).

³ This refers to tax losses and net capital losses.

Section 975-150 of the ITAA 1997 outlines the circumstances in which a person will be in a position to affect the rights of the holding company. The appointment of a liquidator or other external administrator to a holding company will not affect its rights in relation to the subsidiary company for the following reasons:

- Applying paragraph 975-150(1)(a): the liquidator or other external administrator is not a person with a right, power or option to acquire ownership of the company's assets.
- Applying paragraph 975-150(b): the liquidator or other external administrator is not in a position to prevent the holding company from obtaining lawful advantage from the ownership of its shares in the subsidiary.⁴ The liquidator or other external administrator will exercise any voting rights as agent of the holding company for the benefit of the company. Equally, any dividends or capital paid by the subsidiary will be received by the liquidator for the holding company's benefit.

For similar reasons, the ability of both the loss company and the income company to satisfy the 100% beneficial ownership requirement will not be affected where a liquidator is appointed to the subsidiary member or an interposed company.⁵

As a result, being in liquidation does not affect the ability of a holding company or its subsidiary to make a loss transfer agreement under Division 170 as the wholly-owned group requirement is not affected. Therefore, a liquidation member can still be a value donor, and other members can be a value donor to it, provided other conditions in section 707-325 of the IT(TP)A 1997 are also satisfied.

Loss donor provisions and liquidation

The head company may treat one or more of the value donor's losses (if any) as being included in the real loss-maker's bundle under section 707-327 of the IT(TP)A 1997. This enables those losses to be utilised using the available fraction for the real loss-maker.

As a liquidation member can be a value donor, its losses can also be donated to another bundle of losses if other conditions in 707-327 of the IT(TP)A 1997 are satisfied. Also, losses can be donated to the bundle of losses of the liquidation member for the same reasons.

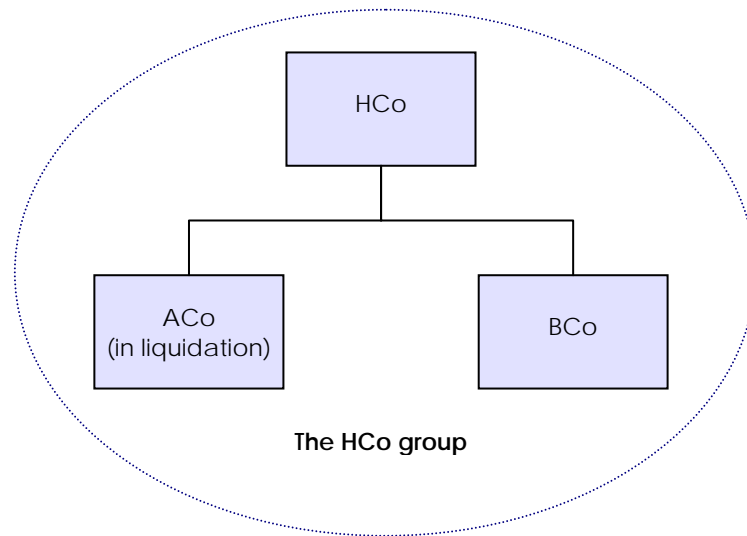
⁴ See Commissioner of Taxation v Linter Textiles Australia Ltd (In Liquidation) (2005) 220 CLR 592; HCA 20, at paragraphs 55–8.

⁵ However, the appointment of an administrator to a subsidiary member or an interposed company may, depending on the terms upon which the administrator is appointed, have a bearing on whether the two companies can satisfy the 100% beneficial ownership requirement.

Example

Facts HCo, ACo and BCo have constituted a wholly-owned group for a number of years. On 12 April 2002, a court orders that ACo be wound up under the Corporations Law. The court appoints a liquidator to the company to administer the winding up of the company. On 1 July 2002, the group consolidates with HCo as the head company and ACo and BCo as subsidiary members (figure 1).

Figure 1: The HCo group structure (1 July 2002)



At the formation time, ACo and BCo have unutilised losses for potential transfer to HCo (table 1).

Table 1: Unutilised losses at formation time

Subsidiary member	Amount (\$m)	Sort	Year incurred
ACo	200	Tax loss	2002
	100	Tax loss	2001
BCo	20	Tax loss	2000

Provided these losses are able to be transferred to HCo at consolidation, HCo seeks to use the value and loss donor concessions in sections 707-325 and 707-327 of the IT(TP)A 1997 to maximise their utilisation.⁶ Market valuations as at the formation time (the initial transfer time) are set out in table 2.

⁶ Note that these losses cannot be utilised using the 1/3 COT concession under section 707-350 of the IT(TP)A 1997 as they were actually made for income years ending after 21 September 1999.

Table 2: Market valuations at initial transfer time

Entity	Modified market value* (\$m)
HCo	300
ACo	nil
BCo	200

* In accordance with 707-325 of the ITAA 1997.

Analysis –
loss transfer

Transfer tests for ACo’s and BCo’s tax losses

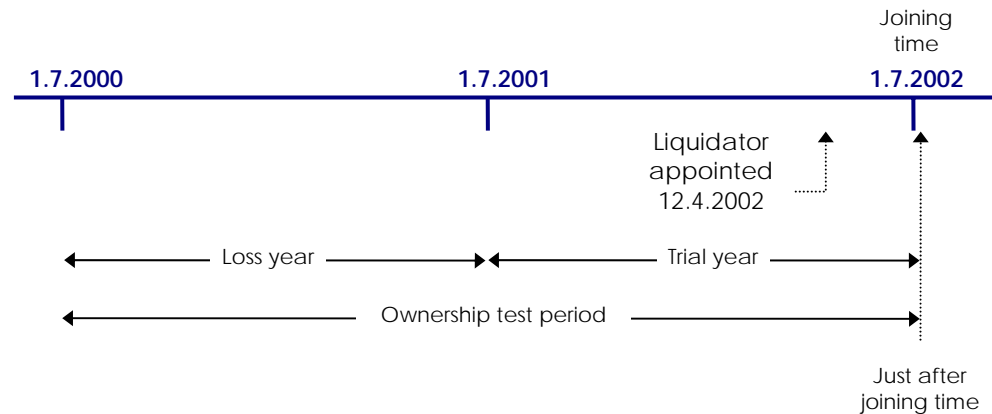
A loss is transferred from ACo or BCo to HCo to the extent that the loss could have been utilised by either ACo or BCo for an income year consisting of the trial year.

Sections 165-12 and 165-15 require the companies to test for same owners and same control respectively throughout the ownership test period (i.e. from the start of the loss year to the end of the income year).

ACo’s tax losses

For ACo’s 2001 tax loss, the loss year is 1 July 2000 to 30 June 2001 and the income year is represented by the trial year – that is, 1 July 2001 to just after 1 July 2002.

Figure 2: The ownership and control tests

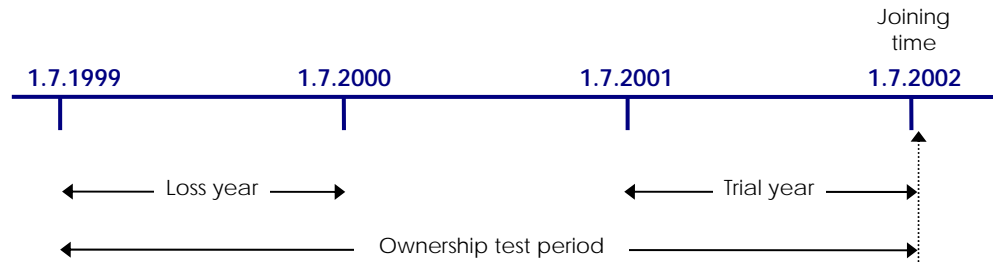


Since there was no ownership or control failure over the ownership test period, ACo’s 2001 tax loss can be transferred to HCo. The fact that ACo had a liquidator appointed on 12 April 2002 does not impact on the application of the continuity of ownership test or the control test → subsection 165-208(1) and section 165-250, ITAA 1997. It follows that ACo’s 2002 tax loss would also satisfy these tests and can be transferred to HCo.

BCo’s 2000 tax loss

For BCo’s 2000 tax loss, the loss year is 1 July 1999 to 30 June 2000 and the income year is represented by the trial year – i.e. 1 July 2001 to just after 1 July 2002.

Figure 3: The ownership and control tests



Since there was no ownership or control failure over the ownership test period, BCo's 2000 tax loss can be transferred to HCo.

Analysis –
available
fraction

Available fraction for losses transferred from ACo

Option 1:

Can HCo choose to donate the tax losses in ACo's bundle to BCo's bundle (assuming HCo was able to add 100% of HCo's modified market value to BCo's modified market value)?

For HCo to donate the tax losses from ACo's bundle into BCo's bundle, so these losses can be utilised using BCo's available fraction, certain conditions contained in section 707-327 of the IT(TP)A 1997 must be met, including:

- an amount of modified market value from ACo is added to the modified market value of BCo under section 707-325 of the IT(TP)A 1997
- ACo could have transferred its tax loss to BCo and HCo under Subdivision 170-A for an income year consisting of the trial year.

For HCo to be able to add an amount of modified market value from ACo to the modified market value of BCo, one of the conditions under section 707-325 of the IT(TP)A 1997 is that BCo could have transferred its tax loss to ACo under Subdivision 170-A for an income year consisting of the trial year. As the appointment of a liquidator on 12 April 2002 does not affect ACo's and BCo's ability to satisfy the condition of being members of the same wholly-owned group during the relevant period, BCo could have transferred its tax losses to ACo assuming other conditions in Subdivision 170-A are also satisfied. As a result, HCo is able to add an amount of modified market value from ACo to the modified market value of BCo.⁷

ACo could have transferred its tax losses to BCo and HCo under Subdivision 170-A for an income year consisting of the trial year for the same reasons. Therefore, HCo can choose to donate the tax losses in ACo's bundle to BCo's bundle and utilise these losses using the available fraction for BCo's bundle.⁸

⁷ Assuming other conditions in section 707-325 of the IT(TP)A 1997 are also satisfied. Note that this amount can be nil according to the note in subsection 707-325(3) of the IT(TP)A 1997.

⁸ Assuming other conditions in section 707-327 of the IT(TP)A 1997 are also satisfied.

Option 2:

Alternatively, for the same reasons, HCo is also able to choose to:

- add a percentage of BCo's modified market value and HCo's modified market value to the modified market value of ACo⁹
- donate the tax loss in BCo's bundle to ACo's bundle.¹⁰

References

Income Tax Assessment Act 1997:

- Subdivision 707-A; as amended by *New Business Tax System (Consolidation) Act (No. 1) 2002* (No. 68 of 2002), Schedule 1
- Subdivisions 170-A & 170-B; as existed prior to the amendments introduced by *New Business Tax System (Consolidation) Act (No. 1) 2002* (No. 68 of 2002) and *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Act 2002* (No. 90 of 2002)
- Division 165; as amended by *Tax Laws Amendment (Loss Recoupment Rules and Other Measures) Act 2005*
- Division 975

Income Tax (Transitional Provisions) Act 1997, Subdivision 707-C; as amended by *New Business Tax System (Consolidation) Act (No. 1) 2002* (No. 68 of 2002), Schedule 2

Explanatory Memorandum to the New Business Tax System (Consolidation) Bill (No. 1) 2002, Chapters 6 and 9

Revision history

Section C3-4-256 first published 12 September 2006.

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).

⁹ Assuming other conditions in section 707-325 of the IT(TP)A 1997 are also satisfied.

¹⁰ Assuming other conditions in section 707-327 of the IT(TP)A 1997 are also satisfied.