*Worked example*

# Donating a value donor's loss where modified market value is added to the value donor (in the capacity of a real loss-maker)

## Description

This example illustrates the effect of subsection 707-327(6) of the *Income Tax (Transitional Provisions) Act 1997* (IT(TP)A). This subsection provides that a value donor's loss cannot be taken to be included in a real loss-maker's bundle if that loss provides the basis for working out the amount of modified market value that is added to the value donor (in its capacity as a real loss-maker) under a separate application of section 707-325 of the IT(TP)A.[1]

**Note**

**For more information about:**

- the value donor concession in section 707-325 of the IT(TP)A → 'Adding to modified market value to reflect loss transferability', C3-4-210 (worked example)
- notionally 'donating' a loss as provided for by section 707-327 of the IT(TP)A → 'Including value donor's loss in real loss-maker's bundle', C3-4-220 (worked example)

## Commentary

Subdivision 707-C of the IT(TP)A sets out the operation of the value donor concession. In broad terms:

- For a company to be a value donor, it must be a company to which the real loss-maker could have transferred, under the group loss transfer rules in Division 170 of the *Income Tax Assessment Act 1997* (ITAA 1997), at least one of the losses in its bundle.
- To be eligible for the concession, both the real loss-maker and the value donor must be companies that join the group when it first consolidates, and the group must consolidate during the transitional period (that is, 1 July 2002 to 30 June 2004).

The head company may also treat one or more of the losses transferred to the head company from the value donor as if it was included in the real loss-maker's bundle for the purpose of determining the amount of the losses that can be utilised by the group in any given income year. Broadly, losses can be treated in this way only if they could be transferred from the value donor to the real loss-maker, and to any of the real loss-maker's other value donors, under the group loss transfer rules.

[1] This is explained in ATO Interpretative Decision ATOID 2005/59.

In some instances, the head company can choose for a company member of the group to be treated as both a value donor and a real loss-maker. In these situations (when considering the company member in its capacity as a value donor), the head company's ability to treat a loss transferred by the company member as if it was included in another bundle of losses can be restricted because of the conditions that need to be satisfied.

## Example

### Facts

HCo and BCo have constituted a wholly-owned group since 24 May 2001. ACo becomes a member of the wholly-owned group on 18 February 2002. The group consolidates on 1 July 2003 and HCo's and BCo's losses are transferred to HCo (figure 1), the head company of the consolidated group, under Subdivision 707-A of the ITAA 1997.

HCo chooses to:

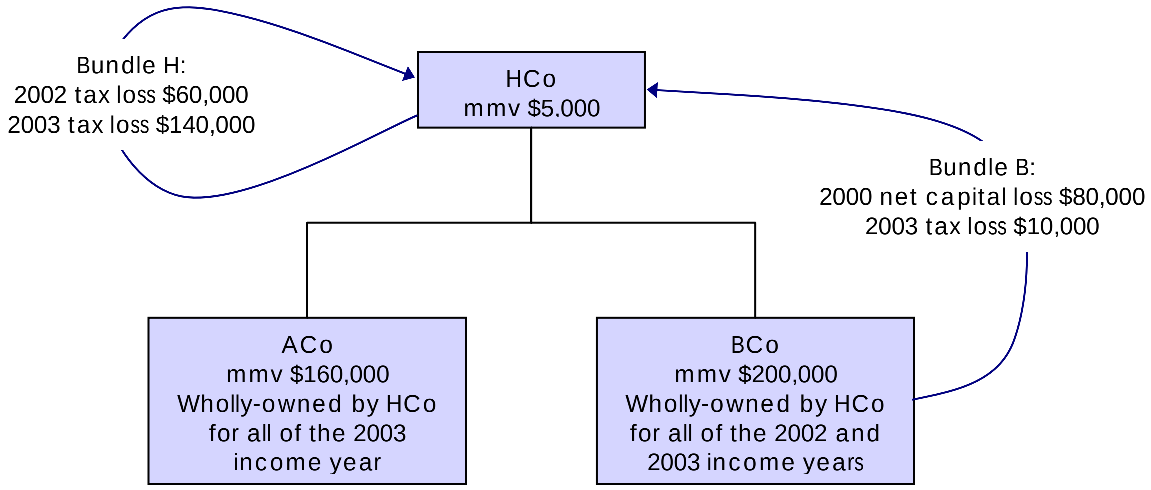
- add to the modified market value of HCo by using an amount of ACo's modified market value, for the purpose of working out the available fraction for the bundle of losses transferred from HCo
- use 100% as the chosen percentage in working out the amount of ACo's modified market value to be added to HCo's modified market value
- add to the modified market value of BCo by using an amount of HCo's modified market value, for the purpose of working out the available fraction for the bundle of losses transferred from BCo
- use 1.08% as the chosen percentage in working out the amount of HCo's modified market value to be added to BCo's modified market value, and
- treat one of the losses transferred from HCo as being included in the bundle of losses transferred from BCo for the purpose of determining its rate of utilisation.

The market value of the consolidated group at the joining time, ignoring losses and assuming a franking account balance of nil, is $365,000.

**Note**

This example is designed to illustrate the operation of some of the rules in Subdivision 707-C of the IT(TP)A (in particular subsection 707-327(6)). The choices made by HCo here are not purported to represent the best outcome for the group in every case where similar circumstances may exist.

**Figure 1: Transfer of losses at time of consolidation (1 July 2003)**




## Calculation

**Adding an amount of ACo's modified market value to HCo's modified market value – HCo in the capacity of a real loss-maker**

For ACo to be able to add to HCo's modified market value, certain conditions set out in subsections 707-325(1) and (2) of the IT(TP)A must be met:

- The bundle of losses transferred from HCo must contain a tax loss or net capital loss (in this case the bundle of losses contains only tax losses) and the utilisation of the loss is not affected by section 707-350 of the IT(TP)A.[2]
- ACo, assuming it had made the loss, could have transferred the loss to HCo under Subdivision 707-A of the ITAA 1997.
- HCo could have transferred the loss to ACo under Subdivision 170-A of the ITAA 1997 for an income year consisting of the trial year.

The amount that is added to HCo's modified market value is worked out in accordance with the formula contained in subsection 707-325(3):

$$\text{ACo's modified market value at initial transfer time} \times \text{Percentage chosen by HCo} \times \frac{\text{Total of HCo's Division 170 losses in bundle}}{\text{Total of HCo's non-foreign losses in bundle}}$$

'Total of HCo's Division 170 losses in bundle' are those losses that meet all of the conditions stated above. The 2003 tax loss meets all of the above conditions.

[2] Section 707-350 of the IT(TP)A provides a concession for the utilisation of certain losses that were originally made by a company for an income year ending on or before 21 September 1999 and transferred to the head company because the continuity of ownership and control tests were satisfied.

‘Total of HCo’s non-foreign losses in bundle’ are those losses that meet the condition contained in the first bullet point. Both the 2002 tax loss and the 2003 tax loss meet the condition.

Substituting the relevant amounts into the above formula the amount added to HCo’s modified market value is:

$$\$160{,}000 \quad \times \quad 100\% \quad \times \quad \frac{\$140{,}000}{\$200{,}000} \quad = \quad \$112{,}000$$

**Adding an amount of HCo’s modified market value to BCo’s modified market value – HCo in the capacity of a value donor**

As with the previous calculation, the conditions set out in subsections 707-325(1) and (2) of the IT(TP)A must be met. For HCo to be able to add to BCo’s modified market value, the conditions are:

- The bundle of losses transferred from BCo must contain either a tax loss or a net capital loss and the utilisation of the loss is not affected by section 707-350 of the IT(TP)A.
- HCo, assuming it had made the loss, could have transferred the loss to itself (as head company) under Subdivision 707-A of the ITAA 1997.
- BCo could have transferred the loss to HCo under Subdivision 170-A or 170-B of the ITAA 1997 for an income year consisting of the trial year.

The amount that is added to BCo’s modified market value is worked out in accordance with the formula contained in subsection707-325(3):

$$\text{HCo's modified market value at initial transfer time}^{3} \quad \times \quad \text{Percentage chosen by HCo} \quad \times \quad \frac{\text{Total of BCo's Division 170 losses in bundle}}{\text{Total of BCo's non-foreign losses in bundle}}$$

‘Total of BCo’s Division 170 losses in bundle’ are those losses that meet all of the conditions stated above. The 2003 tax loss meets all of the above conditions.

‘Total of BCo’s non-foreign losses in bundle’ are those losses that meet the condition contained in the first bullet point. Both the 2000 net capital loss and the 2003 tax loss meet the condition.

[3] Note that this amount does not include the $112,000 of modified market value that is added to HCo from ACo. This amount is only added for the purposes of working out the available fraction for the bundle of losses transferred from HCo.

Substituting the relevant amounts into the above formula the amount added to BCo's modified market value is:

$$\$5{,}000 \quad \times \quad 1.08\% \quad \times \quad \frac{\$10{,}000}{\$90{,}000} \quad = \quad \$6$$

### Available fraction for the bundle of losses transferred from HCo

After taking into account the donation of modified market value from ACo and the donation of modified market value to BCo, the bundle of losses transferred from HCo has an available fraction of:

$$\frac{(5{,}000 - 6) + 112{,}000}{365{,}000} \quad = \quad 0.321$$

### Available fraction for the bundle of losses transferred from BCo

After taking into account the donation of modified market value from HCo, the bundle of losses transferred from BCo has an available fraction of:

$$\frac{200{,}000 + 6}{365{,}000} \quad = \quad 0.548$$

### Treating the 2002 tax loss transferred from HCo as being included in the bundle of losses transferred from BCo

For HCo to notionally transfer the 2002 tax loss from HCo's bundle into BCo's bundle, certain conditions in section 707-327 of the IT(TP)A must be met:

- An amount of modified market value from HCo is added to the modified market value of BCo (this is the $6 of modified market value that is added to BCo from HCo, in HCo's capacity as a value donor to BCo).
- The loss is either a net capital loss or a tax loss (in this case the loss is a tax loss) and the utilisation of the loss is not affected by section 707-350 of the IT(TP)A.
- The loss is transferred under Subdivision 707-A of the ITAA 1997 from HCo to itself (as the head company of the consolidated group) at the time when the group comes into existence.
- Because HCo is a real loss-maker under a separate application of section 707-325 of the IT(TP)A[4], the loss must not be a loss that provides the basis for working out the available fraction under that application. (HCo's 2002 tax loss did not provide the basis for an amount of ACo's modified market value being added to HCo, in HCo's capacity as a real loss-maker, so therefore this condition is satisfied.)[5]

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[4] Where ACo is a value donor to HCo in HCo's capacity as a real loss-maker.

[5] Note that HCo's 2003 tax loss did provide the basis for an amount of ACo's modified market value being added to HCo, so it would not satisfy this condition. Therefore, HCo's 2003 tax loss could not be taken to be included in BCo's bundle because of the operation of subsection 707-327(6) of the IT(TP)A.

- BCo and any of BCo's other value donors (if there were any other value donors), assuming that they had made the loss, could have transferred the loss to HCo (as head company) under Subdivision 707-A of the ITAA 1997.
- HCo could have transferred the loss to BCo, and to any of BCo's other value donors (if there were any other value donors), under Subdivision 170-A of the ITAA 1997 for an income year consisting of the trial year.[6]

All of the above conditions are met in respect of the 2002 tax loss of $60,000 that was transferred from HCo. Therefore the 2002 tax loss of $60,000 will be utilised on the basis of it being included in the bundle of losses transferred from BCo. As stated above, the bundle has an available fraction of 0.548.

## References

*Income Tax Assessment Act 1997*; as amended by *New Business Tax System (Consolidation) Act (No. 1) 2002* (No. 68 of 2002), Schedule 1:

- Subdivisions 170-A, 170-B, 707-A

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

- Subdivision 707-C
- sections 707-325, 707-327, 707-350

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

ATO Interpretative Decision ATOID 2005/59

### Revision history

Section C3-4-255 first published 16 December 2005.

### 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).

[6] Note that if ACo had also been a value donor to BCo, the 2002 tax loss transferred by HCo would not have been able to satisfy this condition because HCo would not have been able to transfer the loss to ACo under Subdivision 170-A of the ITAA 1997 (as HCo and ACo were not members of the same wholly-owned group for the whole of the 2002 income year).