

Worked example

Transfer testing with modified same business test – where ownership or control failed before trial year but after loss year

Description This example shows how the modified same business test applies where the ownership or control tests are failed before the trial year but after the loss year.

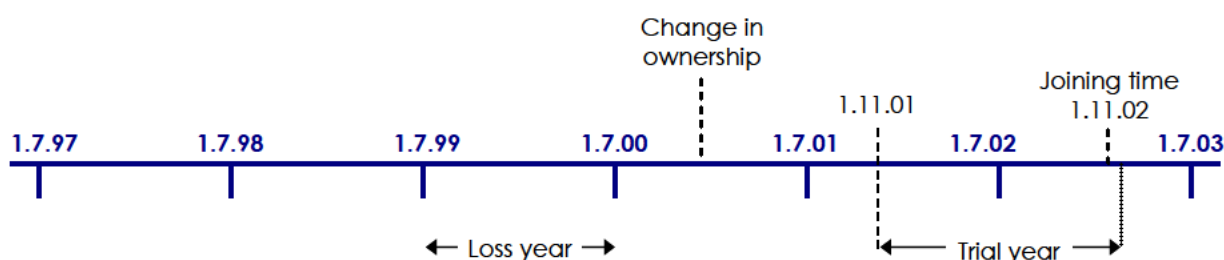
Commentary If a joining entity makes a loss for an income year starting after 30 June 1999 and subsection 165-13(3) or 166-5(4) or (5) of the *Income Tax Assessment Act 1997* is relevant to working out (under subsection 707-120(1)) whether the loss is transferred from the joining entity to the head company, the modified same business test must be considered. The same business transfer test for losses made in an income year that starts after 30 June 1999 is stricter than the normal same business test.

Section 707-125 introduces an additional test point just before the end of the income year in which the loss is made, and tests all of the income year in which the ownership or control tests are failed.

Example

Facts An entity (a company) joins a consolidated group on 1 November 2002. It had experienced a 90% change in ownership before the trial year but after the loss year.

Figure 1: Joining entity timeline



Calculation Step 1: Identify the continuity of ownership test failure

In this case there has been an ownership failure within the *ownership test period* 1 July 1999 to just after 1 November 2002. Accordingly, the tax loss would not be deductible to the joining entity under this test in the trial year. Section 165-10 provides an alternative qualifying test that requires the company to meet the conditions about carrying on the same business.

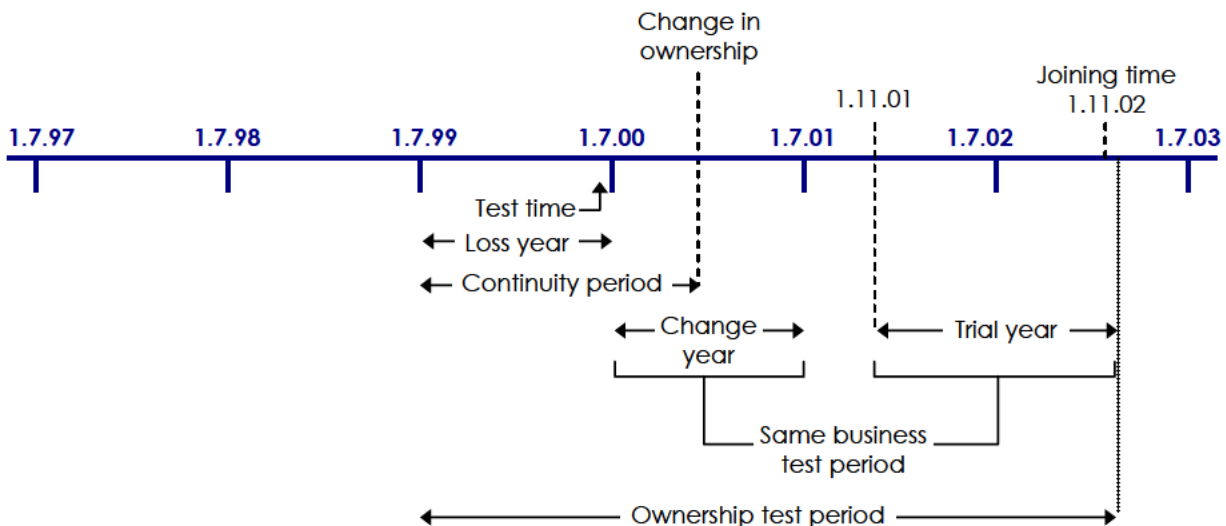
Step 2: Identify the modified same business test points

The company is required to apply the modification to the same business test as stipulated in section 707-125 to work out whether the loss is transferred on the basis that the entity is required to satisfy the same business test for:

- the same business test period, consisting of:
 - the trial year, and
 - the income year in which the *continuity period* ended (the *change year*), if that income year started before the trial year, and
- the *test time*, being the time just before the end of the income year for which the loss was made by the company.

As shown in figure 2, the *change year* in which the *continuity period* ends starts before the start of the trial year. As such, the *same business test period* consists of the periods 1 July 2000 to 30 June 2001 and 1 November 2001 to just after 1 November 2002.

Figure 2: Modified same business test points



Step 4: Apply the same business test

The joining entity now applies the section 165-210 same business test in respect of the identified test times to work out whether the loss is transferred.

Outcome

If the testing process concludes that the same business test was met at the relevant test times, the loss is transferred to the head company.

If the test is not met, the loss is not transferred to the head company and its utilisation will be restricted in accordance with section 707-150 – that is, it cannot be used by any entity for the 2003 and later income years.

References

Income Tax Assessment Act 1997:

- section 165-10
- section 165-12
- section 165-13, subsection 165-13(3)
- subsections 166-5(4), 166-5(5)
- section 165-210

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

- subsections 707-120(1), 707-120(3)
- sections 707-125, 707-150

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