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## Taxation Determination

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Income tax: consolidation: can donations of modified market value to different real loss-makers from the same value donor, under multiple applications of the formula in subsection 707-325(3) of the *Income Tax (Transitional Provisions) Act 1997*, be ordered?

### **Preamble**

The number, subject heading, date of effect and paragraph 1 of this document are a 'public ruling' for the purposes of Part IVA of the **Taxation Administration Act 1953** and are legally binding on the Commissioner.

1. No. When the transferee<sup>1</sup> applies the formula in subsection 707-325(3) of the *Income Tax (Transitional Provisions) Act 1997* (IT(TP)A 1997) more than once, to add modified market value to different real loss-makers from the same value donor, the donation of modified market value are taken to occur simultaneously.
2. Subdivision 707-C of the IT(TP)A 1997 contains the value donor rules. These rules allow the available fraction<sup>2</sup> for a bundle of losses<sup>3</sup> transferred from an entity (the real loss-maker), under Subdivision 707-A of the *Income Tax Assessment Act 1997* (ITAA 1997), to be worked out as if an amount of the modified market value<sup>4</sup> of another entity (the value donor) were added to the modified market value of the real loss-maker.

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<sup>1</sup> The transferee is generally the head company of a consolidated group or the head company of a MEC group.

<sup>2</sup> Within the meaning of section 707-320 of the ITAA 1997.

<sup>3</sup> Within the meaning of section 707-315 of the ITAA 1997.

<sup>4</sup> Within the meaning of section 707-325 of the ITAA 1997.

3. Subsection 707-325(3) of the IT(TP)A 1997 states:

Work out the available fraction for the bundle of losses as if there were added to the modified market value of the real loss-maker at the initial transfer time the amount worked out using the formula:

$$\begin{array}{r} \text{Value donor's modified} \\ \text{market value at initial} \\ \text{transfer time} \end{array} \times \begin{array}{r} \text{Percentage} \\ \text{chosen by} \\ \text{transferee} \end{array} \times \frac{\begin{array}{r} \text{Total of real loss-maker's} \\ \text{Division 170 losses in bundle} \end{array}}{\begin{array}{r} \text{Total of real loss-maker's} \\ \text{non-foreign losses in bundle} \end{array}}$$

**Note:** The amount worked out using the formula will be nil if the value donor's modified market value at the initial transfer time is nil. Even if the amount is nil, section 707-327 may treat losses transferred by the value donor to the transferee as if they were included in the bundle of losses transferred by the real loss-maker to the transferee.

4. The transferee can apply the formula in subsection 707-325(3) of the IT(TP)A 1997 to different real loss-makers in relation to the same value donor. That is, the transferee can choose to donate modified market value to more than one real loss-maker from the same value donor. For each such application, the first element of the formula, that is, the 'value donor's modified market value at the initial transfer time', remains unchanged.

5. Further, subsection 707-325(3) of the IT(TP)A 1997 provides that the addition that is taken to be made to the modified market value of the real loss-maker is at the initial transfer time (the time that the group became a consolidated group),<sup>5</sup> which means that each donation of modified market value is taken to be made at the same time.

6. Subsection 707-325(7) of the IT(TP)A 1997 provides that if subsection 707-325(3) of the IT(TP)A 1997 applies more than once in relation to the same value donor but in respect of different real loss-makers, the sum of the amounts of modified market value taken to be donated (as a result of the separate applications of the formula) cannot exceed the modified market value of the value donor at the initial transfer time. The reference in subsection 707-325(7) to the value donor's modified market value at the initial transfer time confirms that, under multiple applications of the formula in subsection 707-325(3), those donations of modified market value are made at the same time.

7. Where the transferee chooses to apply the formula in subsection 707-325(3) of the IT(TP)A 1997 to different real loss-makers in relation to the same value donor, Subdivision 707-C of the IT(TP)A 1997 makes no reference to whether the donations occur in a particular order. The absence of an ordering rule and the operation of the rules as discussed in paragraphs 4 to 6, leads to the conclusion that donations of modified market value are considered to be made simultaneously.

8. The question of whether an ordering rule exists is relevant from the perspective of how subsection 707-325(7) of the IT(TP)A 1997 operates where there is an over-donation of modified market value. An over-donation occurs where the total of the amounts taken to be donated under subsection 707-325(3) of the IT(TP)A 1997 in relation to a single value donor exceeds that value donor's modified market value at the initial transfer time. This over-donation can arise because of a change in circumstances<sup>6</sup> in respect of a period before the initial transfer time or as a result of an error in calculation.

<sup>5</sup> See paragraph 707-325(1)(b) of the IT(TP)A 1997.

<sup>6</sup> For example, an amendment to the amount of a real loss-maker's loss, which changes the third element in the formula in subsection 707-325(3) of the IT(TP)A 1997, with the consequence that more modified market value will be donated to that real loss-maker than originally calculated.

9. The purpose of subsection 707-325(7) of the IT(TP)A 1997 is to cap the donations of the modified market value to 100% of the value donor's modified market value at the initial transfer time. Subsection 707-325(7) limits the effects of the choices of the transferee under the second element of the formula in subsection 707-325(3) of the IT(TP)A 1997. Those choices made cannot 'result in the total of the amounts worked out under those applications' exceeding the value donor's modified market value at the initial transfer time. Eligible consolidated groups are not denied access to the value donor concession where an over-donation of modified market value is identified but they are prohibited from exceeding the statutory cap.

10. Where a over-donation of modified market value is identified and the time for revoking a choice made under subsection 707-325(5) of the IT(TP)A 1997 has passed, each amount worked out under an application of the formula in subsection 707-325(3) of the IT(TP)A 1997 is required to be proportionally scaled-back to cap the donations to 100% of the value donor's modified market value at the initial transfer time. A proportional scale-back is achieved by multiplying each donation by the following factor:

$$\frac{\text{Value donor's modified market value at the initial transfer time}}{\text{Total over-donation amount}}$$

Where:

*Total over-donation amount* means the total of the amounts worked out under subsection 707-325(3) in relation to the value donor.

11. This does not imply the percentages chosen can be amended by the transferee where an over-donation is identified after the revocation date; it merely scales back each donation so that the applications of the formula have effect.

### **Example**

12 *Head Co forms a consolidated group on 1 July 2003. Loss Co and Donor Co are both subsidiary members at the time that the consolidated group is formed.*

13 *Losses are transferred, under Subdivision 707-A of the ITAA 1997, from Head Co and Loss Co to Head Co (as the head company of the consolidated group) at the time the group forms (the initial transfer time). Head Co chooses (as the remaining conditions in subsections 707-325(1) and 707-325(2) of the IT(TP)A 1997 are satisfied) for Donor Co to be a value donor in working out the available fractions for both the bundle of losses transferred from Head Co and the bundle of losses transferred from Loss Co.*

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14 The details of the bundles of losses transferred from Head Co and Loss Co are as follows:

<i>Loss Transferred from</i>	<i>Details of Loss transferred</i>	<i>Division 170 loss<sup>7</sup> in respect of Donor Co?</i>	<i>Total of non-foreign losses<sup>8</sup> in bundle</i>
Head Co	Tax loss \$1,000 2000-2001 income year	No	
Head Co	Tax loss \$1,000 2001-2002 income year	Yes	\$2,000 (i.e. \$1,000 + \$1,000)
Loss Co	Tax loss \$500 2000-2001 income year	No	
Loss Co	Tax loss \$1,500 2001-2002 income year	Yes	\$2,000 (i.e. \$500 + \$1,500)

15 Donor Co's modified market value at the initial transfer time is \$8,000. In applying the formula in subsection 707-325(3) of the IT(TP)A 1997 to Head Co and Loss Co, in relation to Donor Co, Head Co chooses (within the limitations prescribed by subsection 707-325(5) of the IT(TP)A 1997):

- to use a fixed percentage of 50% in working out the available fraction for the bundle of losses transferred from Head Co; and
- to use a fixed percentage of 100% in working out the available fraction for the bundle of losses transferred from Loss Co.

16 As a result of applying the formula in subsection 707-325(3) of the IT(TP)A 1997, the available fraction for 'bundle Head Co' will be worked out as if there were added to the modified market value of Head Co, the following amount of Donor Co's modified market value:

$$\$8,000 \times 50\% \times 1,000/2,000 = \$2,000$$

17 As a result of applying the formula in subsection 707-325(3) of the IT(TP)A 1997, the available fraction for 'bundle Loss Co' will be worked out as if there were added to the modified market value of Loss Co, the following amount of Donor Co's modified market value:

$$\$8,000 \times 100\% \times 1,500/2,000 = \$6,000$$

18 The donations from Donor Co are taken to be made simultaneously. That is, one donation is not taken to be made before another.

<sup>7</sup> Within the meaning of subsection 707-325(4) of the IT(TP)A 1997.

<sup>8</sup> Within the meaning of subsection 707-325(4) of the IT(TP)A 1997.

19 If it was later (after the time for revoking the choices made under section 707-325 of the IT(TP)A 1997 had passed) discovered that the amount of the 2000-2001 year loss transferred by Loss Co was in fact \$100 (and not \$500), the details of the bundles of losses transferred from Head Co and Loss Co would be adjusted as follows:

Loss Transferred from	Details of Loss transferred	Division 170 loss in respect of Donor Co?	Total of non-foreign losses in bundle
Head Co	Tax loss \$1,000 2000-2001 income year	No	
Head Co	Tax loss \$1,000 2001-2002 income year	Yes	\$2,000 (i.e. \$1,000 + \$1,000)
Loss Co	Tax loss \$100 2000-2001 income year	No	
Loss Co	Tax loss \$1,500 2001-2002 income year	Yes	\$1,600 (i.e. \$100 + \$1,500)

20 As a consequence of the change to the quantum of the 2000-2001 tax loss transferred from Loss Co to Head Co the total amount donated by Donor Co exceeds its modified market value at the initial transfer time. This is illustrated when the formula in respect of Head Co and Loss Co in relation to Donor Co is applied, to take into account the amount of the losses actually transferred:

In respect of bundle Head Co:

$$\$8,000 \times 50\% \times 1,000/2,000 = \$2,000$$

In respect of bundle Loss Co:

$$\$8,000 \times 100\% \times 1,500/1,600 = \$7,500$$

Amount taken to be donated from Donor Co \$9,500 (i.e. \$2,000 + \$7,500)

21 As a consequence of this over-donation subsection 707-325(7) of the IT(TP)A 1997 operates and each application of the formula in relation to Donor Co must be scaled-back. Each donation is proportionally scaled-back as follows:

In respect of bundle Head Co:

$$\$2,000 \times 8,000/9,500 = \$1,684$$

In respect of bundle Loss Co:

$$\$7,500 \times 8,000/9,500 = \$6,316$$

22 Therefore, total scaled-back amounts donated by Donor Co are capped at its modified market value of \$8,000.

## Date of effect

23 This Determination applies to years commencing both before and after its date of issue. However, it does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of the Determination (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

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## Commissioner of Taxation

30 November 2005

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### *Previous draft:*

TD 2005/D14

### *Related Rulings/Determinations:*

TR 92/20

### *Subject references:*

- available fraction
- bundle of losses
- consolidation - formation
- consolidation - losses
- head company
- head company of a MEC group
- real loss-maker
- transferred losses
- utilise a loss
- value donor

### *Legislative references:*

- ITAA 1997 Subdiv 707-A
- ITAA 1997 707-315
- ITAA 1997 707-320
- ITAA 1997 707-325
- IT(TP)A 1997 Subdiv 707-C
- IT(TP)A 1997 707-325
- IT(TP)A 1997 707-325(1)
- IT(TP)A 1997 707-325(1)(b)
- IT(TP)A 1997 707-325(2)
- IT(TP)A 1997 707-325(3)
- IT(TP)A 1997 707-325(4)
- IT(TP)A 1997 707-325(5)
- IT(TP)A 1997 707-325(7)
- IT(TP)A 1997 707-327
- TAA 1953 Pt IVA

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### ATO references

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