



TECHNICAL UPDATE

AMENDMENTS TO COMPANY LOSS RULES

The Federal Government has introduced amendments to the company loss rules contained in the *Tax and Superannuation Laws Amendment (2015 Measures No 2) Bill 2015*. These amendments relate to announcements made by previous Governments to amend the company loss rules in the May 2007 and May 2011 Federal Budgets.

The amendments contained in this Bill seek to:

- Modify the operation of the continuity of ownership test (COT) where the relevant company has different classes of shares on issue which have different rights
- Reduce the difficulty companies may experience in applying COT through super funds and similar entities
- Amend the application of the entry history rule in applying the same business test (SBT) where subsidiary companies become members of a consolidated group.

Continuity of ownership test

Current rules

Under the COT, a company is entitled to access prior year losses where, from the commencement of the income year in which the loss was made to the end of the income year in which the loss is to be used, the same persons beneficially own more than 50 per cent of the shares carrying rights to dividends, capital and voting.

The tests are cumulative – where there is a failure of any of the tests, the company will be unable to access the relevant losses, unless the company can pass SBT.

Where the company has ordinary shares on issue, the test essentially only has to be applied once, as the shares would hold the same dividend, capital and voting rights. However, from a compliance perspective, companies that have shares on issue that hold different rights may experience difficulties in applying the tests.

It is for this reason that the Government is amending the COT. These amendments will apply retrospectively from 1 July 2002.

SECTOR

Tax

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New COT rules

Different dividend or capital rights

Where the company has shares on issue that have different dividend or capital rights, there will be three additional tests that the company may choose to apply where the company cannot determine whether it satisfies COT (note that these tests cannot be applied where the company has determined under the ordinary COT rules that it fails to satisfy continuity of ownership):

- Disregard debt interests (i.e. shares that are treated as debt interests under the debt equity rules) and recalculate continuity of ownership
- If, after disregarding debt interests, the company still cannot demonstrate it satisfies COT (or cannot apply this first test because it does not have debt securities on issue), disregard secondary share classes (not ordinary class shares and where certain other requirements are met) and recalculate continuity of ownership
- If, after disregarding debt interests and secondary share classes, the company still cannot demonstrate it satisfies COT (or cannot apply this second test because it does not have secondary share classes on issue), the company can treat certain shares as having a fixed entitlement to dividends and/or capital, and apply COT on that basis.

This is done according to the relative market values of the shares, or where that is impractical, the allocation is made according to a number of considerations listed in the legislation.

Voting rights

Where the company has shares on issue with different voting rights, the company can choose to apply COT based on the maximum number of votes that may be cast in a poll for:

- The election of company directors or
- The amendment of the company's constitution (other than in relation to voting rights).

Tracing through certain entities

The basic COT test requires companies to trace beneficial ownership of its shares to the individuals who ultimately hold the shares. This may prove difficult where shares in a company are held by super funds, approved deposit funds and similar investors.

Where the company is a widely held company, special rules in Division 166 are available which deem the super fund or approved deposit fund to be the relevant shareholder, thus avoiding the need to trace through the fund to the ultimate shareholders (Division 166).

Prior to the introduction of this amendment, companies that were not widely held could not take advantage of this tracing concession. Under this Bill, companies which do not qualify to apply Division 166, will not have to trace their ultimate ownership where shares are held by a complying super fund, a foreign super fund, complying approved deposit funds, first home saver accounts, special companies and managed investment trusts.

This amendment will take effect retrospectively from 1 July 2011.

Same business test and consolidated groups

The Government is also amending the operation of the same business test (SBT) in the context of consolidated groups. Under the same business test, a company will be able to access prior year losses where it continues to engage in the same business as it previously had, and it does not derive income from any business or transaction that it had not previously carried out.

Under the current consolidations rules, there is confusion over the operation of the entry history rule where a subsidiary company joins a consolidated group which seeks to apply the SBT. Whilst it is clear under the legislation that the entry history rule does not apply for the purposes of testing for the same business, it is not clear whether this extends to the new business and new transactions tests.

To address this technical issue, the amendments make it clear that the entry history rule does not apply for any purpose of the SBT, meaning testing for the same business, new businesses and new transactions.

This amendment will apply retrospectively from 1 July 2002.

BDO comment

These amendments are welcome, as they address technical issues and other inadequacies of the COT and SBT. We also welcome the retrospective application of the provisions, although we would like clarification of how these provisions will be retrospectively applied where assessments are out of time or where audits have been settled on an alternative view. Also concerning is the amount of time that has passed since these amendments were initially identified and announced by Government.

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