

2009

EXPOSURE DRAFT

TAX LAWS AMENDMENT (2009 MEASURES NO 6) BILL:
COMPANY LOSSES

EXPLANATORY MATERIAL

(Circulated by the authority of the
Treasurer, the Hon Wayne Swan MP)

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Chapter 1

Company losses

Outline of chapter

1.1 Schedule 1 to this Bill amends the company loss recoupment rules in the *Income Tax Assessment Act 1997* (ITAA 1997) by:

- modifying the continuity of ownership test for companies whose shares have unequal rights to dividends, capital distributions or voting power; and
- clarifying that the entry history rule does not operate in relation to an entity that becomes a subsidiary member of a consolidated group or multiple entry consolidated group (MEC group) for the purposes of applying the same business test.

Context of amendments

1.2 Under the company loss recoupment rules, a company is able to claim deductions for prior year tax losses and bad debts, or apply net capital losses, only if it satisfies the continuity of ownership test or the same business test.

1.3 Similarly, any prior year losses or non-membership period losses of a company that joins a consolidated group or a MEC group can be transferred to the head company of the group only if the company satisfies one of these tests at the joining time.

1.4 The continuity of ownership test broadly requires that the shares carrying more than 50 per cent of all voting, dividend and capital rights be beneficially owned by the same persons:

- at all times during the ownership test period; or
- at specific testing times in the ownership test period.

1.5 The ownership test period is, generally:

- the period from the start of the loss year to the end of the income year in which the loss is to be deducted; or
- if the company joins a consolidated group or MEC group, the period from the start of the loss year to the end of a trial year.

1.6 Companies may have difficulty in satisfying the continuity of ownership test where they have shares with unequal rights to dividends, capital distributions or voting power. In these circumstances, companies may technically fail the continuity of ownership test even though there is no significant change in underlying beneficial ownership during the ownership test period.

1.7 A company which has more than one class of shares with different owners could technically fail the continuity of ownership test because, for example, if the classes of shares have unequal rights to dividends and capital distributions or unequal voting power, it may be difficult to identify which particular group of owners have more than 50 per cent of the relevant rights or voting power at a particular time.

1.8 The same business test broadly requires a company to carry on the same business at the following times:

- immediately before the ‘test time’ (which is generally either the point in time at which the continuity of ownership test is no longer satisfied, or the start of the income year when the loss is incurred where it is not practicable for the company to show that there is a period during which it has satisfied the continuity of ownership test); and
- throughout the income year the loss is claimed as a deduction.

1.9 These times are modified when a company joins a consolidated group or MEC group.

1.10 Difficulties arise in applying the same business test to the head company of a consolidated group or MEC group because of the operation of the entry history rule.

Summary of new law

Modifications to the continuity of ownership test

1.11 The continuity of ownership test is modified for companies whose shares have unequal rights to dividends, capital distributions or voting power.

1.12 Under these modifications, if a company fails the continuity of ownership test, it may reconsider the test after:

- disregarding debt interests; and
- disregarding secondary share classes.

1.13 If a company continues to fail the continuity of ownership test after disregarding debt interests and secondary share classes, then the remaining shares may be taken to have fixed dividend and capital distribution rights for the purpose of applying the test.

1.14 In addition, the continuity of ownership test will be modified so that, if the shares of a company have different voting rights, the voting power of those shares is tested solely by reference to the maximum number of votes that could be cast on a poll for the election of the company's directors or on the adoption or amendment of the company's constitution.

Modifications to the same business test

1.15 The same business test is modified for the head company of a consolidated group or MEC group to ensure that the entry history rule does not operate in relation to an entity becoming a subsidiary member of the group.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
<p>A company that fails the continuity of ownership test because it has shares with unequal rights to dividends or capital distributions will be able to choose to reconsider the test after:</p> <ul style="list-style-type: none"> • disregarding debt interests; and • disregarding secondary classes of shares. <p>If the company continues to fail the continuity of ownership test after disregarding debt interests and secondary classes of shares, then the remaining shares will be taken to have fixed dividend and capital distribution rights for the purpose of applying the test.</p>	<p>Under the company loss recoupment rules, a company is able to deduct prior year tax losses and bad debts, or apply net capital losses, only if it satisfies the continuity of ownership test or the same business test.</p> <p>A company that has shares with unequal rights to dividends, capital distributions or voting power may technically fail the continuity of ownership even though there is no significant change in underlying beneficial ownership during the ownership test period.</p>
<p>If the shares of a company have different voting rights, for the purpose of applying the continuity of ownership test, the voting power of those shares will be tested solely by reference to the maximum number of votes that could be cast on a poll for the election of the company's directors or on the adoption or amendment of the company's constitution.</p>	<p>If the shares of a company have different voting rights, the company may fail the continuity of ownership test because it is unable to determine the voting power attached to the shares.</p>
<p>For the purpose of applying the same business test, the head company of a consolidated group or MEC group will not need to take into account the history of a subsidiary member prior to the time that it joined the group.</p>	<p>For the purpose of applying the same business test, the head company of a consolidated group or MEC group may need to take into account the history of a subsidiary member prior to the time that it joined the group.</p>

Detailed explanation of new law

Continuity of ownership test modified for companies whose shares have unequal rights to dividends, capital distributions or voting power

1.16 New Division 167 modifies the continuity of ownership test for companies whose shares have unequal rights to dividends, capital distributions or voting power so that companies may test the possession of those rights in a way that is analogous to a company whose shares are all of a single class with the same rights. *[Schedule 1, item 1, sections 167-1, 167-5 and 167-75]*

1.17 The modifications that may apply depend upon whether the company has:

- shares with unequal rights to dividends or capital distributions; or
- shares with different voting rights.

Companies with shares that have unequal rights to dividends or capital distributions

Reconsideration of the continuity of ownership test

1.18 The continuity of ownership test (including certain loss integrity rules) can be reconsidered in relation to a company if:

- the company fails the continuity of ownership test because it is unable to satisfy certain conditions at a particular time; and
- the company, or a holding company that has a shareholding interest in the company, has an unfixed share structure at the relevant time.

[Schedule 1, item 1, subsection 167-10(1)]

Company fails the continuity of ownership test because it is unable to satisfy certain conditions

1.19 The first element of the test in subsection 167-10(1) is that a company must fail the continuity of ownership test (including certain loss integrity rules) because it is unable to satisfy one of the four conditions (the unsatisfied conditions) specified in the table in subsection 167-10(1) at a particular time. *[Schedule 1, item 1, paragraph 167-10(1)(a)]*

1.20 The first unsatisfied condition specified in the table in subsection 167-10(1) is the condition that there must be persons who have rights to more than 50 per cent of the company's dividends or capital distributions at all times during the test period. *[Schedule 1, item 1, item 1 of the table in subsection 167-10(1)]*

1.21 The second unsatisfied condition specified in the table in subsection 167-10(1) is the condition for widely held companies and eligible Division 166 companies in subsection 166-145(3), subsection 166-145(4) or paragraph 166-270(2)(c).

- Under the condition in subsections 166-145(3) and (4), broadly, there must be persons (other than companies) who have rights to more than 50 per cent of the company's dividends or capital distributions at the relevant times in the test period.
- Under the condition in paragraph 166-270(2)(c), single notional entity stakeholders are taken to have minimum dividend rights and capital rights at the relevant times in the test period.

[Schedule 1, item 1, item 2 of the table in subsection 167-10(1)]

1.22 The third unsatisfied condition specified in the table in subsection 167-10(1) is, for companies that have had a change of ownership or control (that is, a changeover time or an alteration time), the condition in paragraphs 165-115C(1)(b), 165-115C(1)(c), 165-115L(1)(b) or 165-115L(1)(c). Under that condition, broadly, there must be persons who had rights to more than 50 per cent of the company's dividends or capital distributions at the two times referred to in the paragraphs. *[Schedule 1, item 1, item 3 of the table in subsection 167-10(1)]*

1.23 The fourth unsatisfied condition specified in the table in subsection 167-10(1) is any other relevant condition that requires one or more entities to have the right to receive a percentage of the company's dividends or capital distributions that is higher than or lower than a particular limit, or within two particular limits. *[Schedule 1, item 1, item 4 of the table in subsection 167-10(1)]*

1.24 However, the continuity of ownership test cannot be reconsidered if the unsatisfied condition was the condition in paragraph 166-245(5)(b). *[Schedule 1, item 1, item 4 of the table in subsection 167-10(1)]*

1.25 The condition in paragraph 166-245(5)(b) broadly, modifies the ownership test tracing concession for certain types of entities (such as superannuation funds and managed investment schemes) that have more than 10 members where the proportion of voting power, rights to dividends or capital distributions in or paid by the tested entity which is held by each member is less than 10 per cent.

Company has an unfixed share structure

1.26 The second element of the test in subsection 167-10(1) is that a company, or a holding company that has a shareholding interest in the company, must have an unfixed share structure at the relevant time. *[Schedule 1, item 1, paragraph 167-10(1)(b)]*

1.27 A holding company has a shareholding interest in a company if, broadly, the holding company is the beneficial owner of shares, or of an interest in shares, in the company (section 175-95).

1.28 A company has an **unfixed share structure** at a particular time if, at that time, its shares do not all have the same rights to any dividends and capital distributions of the company. *[Schedule 1, items 1 and 41, subsection 167-10(2) and the definition of ‘unfixed share structure’ in subsection 995-1(1)]*

1.29 A company is likely to have an unfixed share structure at a particular time if, for example, it has multiple classes of shares on issue at that time.

Debt interests disregarded

1.30 When a company that has an unfixed share structure fails the continuity of ownership test because it is unable to satisfy one of the specified conditions, the company may reconsider the continuity of ownership test after disregarding any debt interests in the company and/or in the holding company. *[Schedule 1, item 1, section 167-15]*

1.31 A ‘debt interest’ in an entity is defined to have the meaning given by Subdivision 974-B (see the definition of ‘debt interest’ in subsection 995-1(1)). Broadly an interest in an entity will be a debt interest if it satisfies the debt test in section 974-20.

Example 1.1

Zed Company has the following shareholdings on 1 July 2011:

- Alex owns 100 ordinary shares;
- Barry owns 100 ordinary shares;

- Claude owns 50 ordinary shares and 100 shares that are debt interests; and
- David owns 50 ordinary shares and 100 shares that are debt interests.

The shares that are debt interests have first priority rights to dividends and capital distributions, but do not carry any voting power (as defined in section 167-80).

Zed Co makes a \$500 tax loss in the 2011-12 income year.

On 1 July 2012, Claude and David sell all of their ordinary and debt interest shares to Edward.

Zed Co has a taxable income (before deducting tax losses) of \$1,000 in the 2012-13 income year. It seeks to deduct the \$500 tax loss from its taxable income for the income year.

The ownership test period is from the start of the loss year (1 July 2011) to the end of the income year in which the loss is to be deducted (30 June 2013).

The continuity of ownership test is applied to all 500 shares in the first instance. On 30 June 2013, Alex and Barry hold 200 ordinary shares. These shares have been held throughout the ownership test period. As the different classes of shares have unequal rights, Zed Co is unable to satisfy the dividend and capital distribution conditions of the continuity of ownership test. Consequently, both conditions in item 1 of the table in subsection 167-10(1) cannot be satisfied at all times during the ownership test period.

However, Zed Co reconsiders both of these conditions under section 167-15 and disregards any debt interests in the company during the ownership test period. Therefore, the 200 debt interest shares are disregarded.

As Alex and Barry have continually held 200 of the remaining 300 ordinary shares in Zed Co, they have held rights to more than 50% of the company's dividend and capital distributions throughout the ownership test period.

After disregarding the debt interests, Zed Co satisfies the continuity of ownership test because of majority continuity of:

- voting power; and
- rights to dividends and capital distributions.

Therefore, Zed Co is able to deduct the prior year tax loss of \$500 in the 2012-13 income year.

Secondary share classes disregarded

1.32 When a company that has an unfixed share structure fails the continuity of ownership test because it is unable to satisfy one of the specified conditions, the company may reconsider the continuity of ownership test if:

- the specified condition remains unsatisfied after debt interests are disregarded;
- after disregarding debt interests, the company has a 'principal class of shares' (as defined in subsection 995-1(1)) and at least one other class of shares at one or more of the test times;
- the market value of each of the secondary classes of shares at each of the test times that those shares were on issue does not exceed 10 per cent of the total market value of the company's shares – the total market value of the company's shares at a particular time is the sum of the market values of all of the shares (disregarding debt interests) in the company at that time; and
- if there was more than one other class of shares on issue at one or more of the test times, the aggregate market value of the other classes of shares does not exceed 25 per cent of the total market value of the company's shares.

1.33 In these circumstances, the company may reconsider an unsatisfied condition under the continuity of ownership test taking into account only the principal class of shares. [*Schedule 1, item 1, section 167-20*]

Example 1.2

Wai Company has the following shareholders on 1 July 2011:

- Frances owns 500 ordinary shares;
- Gabrielle owns 500 ordinary shares;
- Hermione owns 200 ordinary shares and 100 preference shares; and
- Indira owns 200 ordinary shares and 100 shares that are debt interests.

The shares that are debt interests have first priority rights to dividends and capital distributions, but do not carry any voting power (as defined in section 167-80). The preference shares have the second priority rights to dividends and capital distributions, but do not carry any voting power. The ordinary shares, which carry voting power, have last priority rights to dividends and capital distributions.

Wai Co makes a \$1,000 tax loss in the 2011-12 income year.

On 1 July 2012, Hermione and Indira sell all of their ordinary shares, preference shares and debt interest shares to Jacqueline.

During the ownership test period, the market value of each ordinary share is \$1 and the market value of each preference share is \$1.50.

Wai Co has a taxable income (before deducting tax losses) of \$4,000 in the 2012-13 income year. It seeks to deduct the \$1,000 tax loss from its taxable income for the income year.

The ownership test period is from the start of the loss year (1 July 2011) to the end of the income year in which the loss is to be deducted (30 June 2013).

The continuity of ownership test is applied to all 1,600 shares in the first instance. On 30 June 2013, Frances and Gabrielle hold 1,000 ordinary shares. These shares have been held throughout the ownership test period. As the different classes of shares have unequal rights, Wai Co is unable to satisfy the dividend and capital distribution conditions of the continuity of ownership test. Consequently, both conditions in item 1 of the table in subsection 167-10(1) cannot be satisfied at all times during the ownership test period.

Wai Co reconsiders both of the unsatisfied conditions under section 167-15 and disregards the 100 debt interest shares. However, as the different classes of shares with unequal rights remain, Wai Co is still unable to satisfy the dividend and capital distribution conditions of the continuity of ownership test.

Wai Co further reconsiders both of the unsatisfied conditions under section 167-20. After disregarding the 100 debt interest shares, Wai Co has a principal class of shares (being the 1,400 ordinary shares) and a secondary class of shares (being the 100 preference shares) during the ownership test period.

As the market value of the preference shares (\$150) does not exceed 10% of the total market value of Wai Co shares ($(\$150 + \$1,400) \times 10\% = \$155$), the unsatisfied conditions can be reconsidered having regard solely to the ordinary shares (being the principal class of shares).

As Frances and Gabrielle have continually held 1,000 of the remaining 1,400 ordinary shares in Wai Co, they have held rights to more than 50% of the company's dividend and capital distributions throughout the ownership test period.

After disregarding the debt interests and a secondary share class, Wai Co satisfies the continuity of ownership test because of majority continuity of:

- voting power; and
- rights to dividends and capital distributions.

Therefore, Wai Co satisfies the continuity of ownership test and is able to deduct the prior year tax loss of \$1,000 in the 2012-13 income year.

Shares taken to have fixed rights to dividends and capital distributions

1.34 If a company that has an unfixed share structure continues to fail the continuity of ownership test after disregarding debt interests and secondary share classes, then, unless the exception in subsection 167-30 applies, the company may reconsider any unsatisfied condition as if:

- the shares in the company (whether the subject company or a holding company) at the test time consisted solely of the remaining shares; and
- those remaining shares had a fixed percentage of the rights to receive dividends and capital distributions.

[Schedule 1, item 1, subsections 167-25(1) and (2)]

1.35 The remaining shares are:

- if the unsatisfied condition was reconsidered under section 167-20, the principal class of shares;
- otherwise, all shares other than debt interests in the company.

[Schedule 1, item 1, subsection 167-25(2)]

1.36 The fixed percentage of the rights to receive dividends and capital distributions from the company is worked out under the method statement in subsection 167-25(2).

Step 1 of the method statement: Work out the last event

1.37 The first step is to work out which event, from a range of specified events, is the last event. The last event is the last of the following events to happen between the first test time and the last test time:

- the first test time;
- an issue of shares of a class included in the remaining shares;
- a variation of the rights attached to any remaining shares to receive dividends and/or capital distributions; and
- a cancellation of any remaining shares.

[Schedule 1, item 1, step 1 of the method statement in subsection 167-25(2)]

1.38 For these purposes, if certain loss integrity rules are being reconsidered because of item 3 of the table in subsection 167-10(1) (which applies to companies that have had a change of ownership or control resulting in a changeover time or an alteration time), then the reference to the first test time in steps 1 and 2 of the method statement is taken to be a reference to the company's reference time (worked out under subsection 165-115A(2A) or 165-115M(2), as the case requires).

[Schedule 1, item 1, subsection 167-25(5)]

1.39 In addition, if the continuity of ownership test is being reconsidered because of item 4 of the table in subsection 167-10(1) (which applies to any other relevant condition that requires one or more entities to have the right to receive a percentage of the company's dividends or capital distributions that is higher than or lower than a particular limit, or within two particular limits, other than a condition covered by another item in the table or the condition in paragraph 166-245(5)(b)), then:

- the reference to the first test time in steps 1 and 2 of the method statement is taken to be:
 - for a relevant condition specified in Subdivision 165-CD (which prevents multiple recognition of a company's losses when significant equity and debt interests that entities have in the company are realised), a reference to the company's reference time (worked out under subsection 165-115M(2));

- for a relevant condition specified in Division 166 (which provides for concessional tracing rules which make it easier for widely held companies and eligible Division 166 companies to satisfy the continuity of ownership test), a reference to the start of the company's loss year;
- for a relevant condition specified in Subdivision 170-D (which relates to transactions by a company that is a member of a linked group), a reference to the time that the deferral event referred to in paragraph 170-255(1)(a) happens involving the company; and
- the reference to the last test time in step 1 of the method statement is taken to be a reference to the test time.

[Schedule 1, item 1, subsection 167-25(6)]

Step 2 of the method statement: Determine if it is reasonably practicable to work out the relative market value of each remaining share at certain valuing times

1.40 The second step is to determine if it is reasonably practicable for the company to work out the relative market value of each remaining share at the following valuing times:

- if the last event is the first test time or an issue of shares, immediately after the time of that event;
- if the last event is a variation of the rights attached to any remaining shares, immediately before and after the time of that event; or
- if the last event is a cancellation of any remaining shares, immediately before the time of that event.

[Schedule 1, item 1, step 2 of the method statement in subsection 167-25(2)]

1.41 Where the share is not listed on a securities exchange, the costs of obtaining a valuation would be a factor to consider in determining whether it is reasonably practicable to work out the market value of a remaining share.

Step 3 of the method statement: Working out the relative rights of each remaining share where it is reasonably practicable to work out the relative market value of each remaining share at certain valuing times

1.42 The third step applies where it is reasonably practicable for the company to work out the relative market value of each remaining share at the relevant valuing time. *[Schedule 1, item 1, step 3 of the method statement in subsection 167-25(2)]*

1.43 If step 3 of the method statement applies, the relative rights of each remaining share to receive dividends and capital distributions at the valuing times are worked out on the basis that a share is taken to carry a percentage of the rights to receive dividends and capital distributions from the company worked out under the formula:

$$\frac{\text{Share's market value}}{\text{Sum of market values of all of the company's remaining shares}} \times 100$$

[Schedule 1, item 1, step 3 of the method statement in subsection 167-25(2) and subsection 167-25(3)]

1.44 For the purposes of applying the formula, the market value of all the company's remaining shares is worked out at the valuing time, or at each of the valuing times. *[Schedule 1, item 1, subsection 167-25(3)]*

Step 4 of the method statement: Working out the relative rights of each remaining share where it is not reasonably practicable to work out the relative market value of each remaining share at certain valuing times

1.45 The fourth step applies where it is not reasonably practicable for the company to work out the relative market value of each remaining share at the relevant valuing time. *[Schedule 1, item 1, step 4 of the method statement in subsection 167-25(2)]*

1.46 If step 4 of the method statement applies, the relative rights of each remaining share to receive dividends and capital distributions at the valuing times are worked out on the basis that a share is taken to carry a percentage of the rights to receive dividends and capital distributions that is reasonable having regard to the purpose of the unsatisfied condition in the continuity of ownership test. In determining what is reasonable, regard must be had to:

- the company's constitution;
- any agreements between the company and its shareholders (including any associate of a shareholder);

- any statement by the company of its policy in paying dividends or making capital distributions;
- the ability of an entity to control (either directly or indirectly through one or more interposed entities) how the company pays dividends or makes capital distributions;
- how the company has previously paid dividends or made capital distributions;
- whether all classes of shares carry substantially the same rights to receive dividends and capital distributions; and
- the principle that a tax loss should only be deductible if a majority of the persons owning or controlling the company is maintained.

[Schedule 1, item 1, step 4 of the method statement in subsection 167-25(2) and subsection 167-25(4)]

Step 5 of the method statement: Specifying when the rights attached to a share are taken to exist for the purpose of applying steps 3 and 4

1.47 The final step of the method statement specifies when the rights attached to a share are taken to exist for the purpose of applying steps 3 and 4 of the method statement.

1.48 If the last event is a variation of the rights attached to any remaining shares:

- the rights of a share worked out under step 3 or 4 of the method statement at the earlier valuing time are taken to exist for the share at each of the test times when the share was on issue before the last event; and
- the rights of a share worked out under step 3 or 4 of the method statement at the later valuing time are taken to exist for the share at each of the test times when the share was on issue after the last event.

[Schedule 1, item 1, step 5 of the method statement in subsection 167-25(2)]

1.49 If the last event is not a variation of the rights attached to any remaining shares, the rights of a share worked out under step 3 or 4 of the method statement are taken to exist for the share at each of the test times when the share was on issue. *[Schedule 1, item 1, step 5 of the method statement in subsection 167-25(2)]*

Example 1.3

Kommissar Co Pty Ltd has the following shareholders on 1 July 2011:

- Lisel owns 550 ordinary shares and 100 shares that are debt interests;
- Mark owns 300 preference shares; and
- Olivier owns 450 ordinary shares, 50 preference shares and 250 shares that are debt interests.

The shares that are debt interests have first priority rights to dividends and capital distributions, but do not carry any voting power (as defined in section 167-80). The preference shares have the second priority rights to dividends and capital distributions, but do not carry any voting power. The ordinary shares, which carry voting power, have last priority rights to dividends and capital distributions.

Kommissar Co makes a \$1,000 tax loss in the 2011-12 income year.

On 1 July 2012, Olivier sells his preference shares and debt interest shares to Paula.

During the ownership test period, the market value of each ordinary share is \$1 and the market value of each preference share is \$1.50.

In the 2012-13 income year, Kommissar Co has a taxable income (before deducting tax losses) of \$5,000. It seeks to deduct the \$1,000 tax loss from its taxable income for the income year.

The ownership test period is from the start of the loss year (1 July 2011) to the end of the income year in which the loss is to be deducted (30 June 2013).

The continuity of ownership test is applied to all 1,700 shares in the first instance. On 30 June 2013:

- Lisel and Olivier hold 1,000 ordinary shares, which have been held throughout the ownership test period;
- Mark holds 300 preference shares, which have been held throughout the ownership test period.

As the different classes of shares have unequal rights, Kommissar Co is unable to satisfy the dividend and capital distribution conditions of the continuity of ownership test. Consequently, both conditions in item 1 of the table in subsection 167-10(1) cannot be satisfied at all times during the ownership test period.

Kommissar Co reconsiders both of these unsatisfied conditions under section 167-15 and disregards the 350 debt interest shares held in the company throughout the ownership test period. However, as different classes of shares with unequal rights continue to exist, Kommissar Co is still unable to satisfy the dividend and capital distribution conditions of the continuity of ownership test.

Kommissar Co further reconsiders the unsatisfied conditions in item 1 of the table in subsection 167-10(1) under section 167-20. After disregarding the debt interests (being the 350 debt interest shares), during the ownership test period Kommissar Co has:

- a principal class of shares — being the 1,000 ordinary shares; and
- a secondary class of shares — being the 350 preference shares.

At the test times (being all times during the ownership test period):

- the market value of the preference shares is \$525 (350 x \$1.50); and
- the total market value of all of the company's shares (disregarding debt interests) is \$1,525 ((1,000 ordinary shares x \$1) + (350 preference shares x \$1.50)).

As the market value of the preference shares (\$525) exceeds 10% of the total market value of all of the company's shares (\$1,525 x 10% = \$152.50), Kommissar Co cannot reconsider the unsatisfied conditions under section 167-20 by disregarding the secondary class of shares (that is, the preference shares).

Therefore, Kommissar Co reconsiders the unsatisfied conditions in item 1 of the table in subsection 167-10(1) under section 167-25 as if:

- the shares in the company consisted solely of the ordinary shares and the preference shares — that is, the debt interest shares are disregarded; and
- those shares had fixed rights to receive dividends and capital distributions relative to their market value at certain test times.

As the preference shares were in existence before the ownership test period commenced and none of the other events listed in step 1 of the method statement in subsection 167-25(2) occurred in respect of those shares, the first test time is the last event (step 1 of the method statement).

It is reasonably practicable for Kommissar Co to work out the relative market value of each remaining share at the valuing time, which is immediately after the time of the last event (step 2 of the method statement in subsection 167-25(2)). As the last event was on 1 July 2011:

- the market value of each ordinary share immediately after the last event was \$1; and
- the market value of each preference share immediately after the last event was \$1.50.

As it is reasonably practicable for Kommissar Co to work out the relative market value of each remaining share at the valuing time under step 2 of the method statement, the relative rights of each remaining share to receive dividends and capital distributions at the valuing time is worked out under the formula in subsection 167-25(3) — that is, step 3 of the method statement applies. Applying that formula:

- each ordinary share is taken to carry 0.06557% of the rights to receive dividends and capital distributions from the company at the valuing time, worked out as follows:

$$\begin{aligned} & \frac{\text{Market value of the ordinary share}}{\left(\text{Market value of all ordinary shares} \right) + \left(\text{Market value of all preference shares} \right)} \times 100 \\ &= \frac{\$1.00}{(1,000 \times \$1.00) + (350 \times \$1.50)} \times 100 \\ &= 0.06557\%. \end{aligned}$$

- each preference share is taken to carry 0.09836% of the rights to receive dividends and capital distributions from the company at the valuing time, worked out as follows:

$$\begin{aligned} & \frac{\text{Market value of the preference share}}{\left(\text{Market value of all ordinary shares} \right) + \left(\text{Market value of all preference shares} \right)} \times 100 \\ &= \frac{\$1.50}{(1,000 \times \$1.00) + (350 \times \$1.50)} \times 100 \\ &= 0.09836\%. \end{aligned}$$

At the valuing time (which is immediately after the beginning of the ownership test period):

- Lisel, who held 550 ordinary shares, had 36.06% (550 x 0.06557%) of the rights to receive dividends and capital distributions from the company;
- Mark, who held 300 preference shares, had 29.51% (300 x 0.09836%) of the rights to receive dividends and capital distributions from the company;
- Olivier, who held 450 ordinary shares and 50 preference shares, had 34.43% of the rights to receive dividends and capital distributions from the company – that is:
 - the 450 ordinary shares had 29.51% (450 x 0.06557%) of the rights to receive dividends and capital distributions from the company; and
 - the 50 preference shares had 4.92% (50 x 0.09836%) of the rights to receive dividends and capital distributions from the company.

As the last event was the first test time, these proportionate rights to receive dividends and capital distributions at the valuing time are taken to exist for each share at each of the test times when the share was on issue (step 5 of the method statement in subsection 167-25(2)).

In this example, the test times are all times during the ownership test period.

As Lisel and Olivier have continually held all 1,000 of the ordinary shares, and Mark has continually held 300 of the 350 remaining preference shares, in Kommissar Co, they have held rights to more than 50% of the company's dividends and capital distributions throughout the ownership test period.

Therefore, Kommissar Co satisfies the continuity of ownership test because of majority continuity of voting power, and rights to dividends and capital distributions, and is able to deduct the prior year tax loss of \$1,000 in the 2012-13 income year.

No reconsideration where an unsatisfied condition could have been satisfied in an earlier income year

1.50 A company that has an unfixed share structure which continues to fail the continuity of ownership test after disregarding debt interests and secondary share classes cannot reconsider the unsatisfied conditions under section 167-25 if:

- the unsatisfied condition is a condition mentioned in item 1 or (2) of the table in subsection 167-10(1) that must be satisfied for the subject company to deduct a tax loss, or apply a net capital loss, for an income year; and
- the subject company could have deducted the tax loss, or applied the net capital loss, for an earlier income year if the unsatisfied condition could have been satisfied for that earlier income year.

[Schedule 1, item 1, section 167-30]

1.51 This is an integrity rule to ensure that losses cannot be refreshed by a reconsideration of the continuity of ownership test under Subdivision 167-A in an income year following a failure of the test after reconsideration under the Subdivision in an earlier income year.

Example 1.4

Wooster Co has the following shareholdings on 1 July 2011:

- Agatha owns 100 ordinary shares, with a market value of \$55,000;
- Bertram owns 100 preference shares (which are not debt interests), with a market value of \$45,000.

The preference shares have first priority rights to dividends and capital distributions. The ordinary shares carry 100% of the voting power (as defined in section 167-80) at all relevant times.

Wooster Co makes a \$10,000 tax loss in the 2011-12 income year.

On 1 July 2012 a resolution comes into force which varies the rights to dividends and capital distributions attached to the ordinary and preference shares. As a result:

- the market value of Agatha's ordinary shares declines to \$5,000; and
- the market value of Bertram's preference shares increases to \$95,000.

The change in market value corresponds to the changed rights to dividends and capital distributions of the two classes of shares.

Wooster Co has a taxable income (before deducting tax losses) of \$25,000 in the 2012-13 income year. It seeks to deduct the \$10,000 tax loss from its taxable income for the income year.

The ownership test period is from the start of the loss year (1 July 2011) to the end of the income year in which the loss is to be deducted (30 June 2013).

As the different classes of shares have unequal rights, Wooster Co is unable to satisfy the dividend and capital distribution conditions of the continuity of ownership test. Consequently, both conditions in item 1 of the table in subsection 167-10(1) cannot be satisfied at all times during the ownership test period.

The unsatisfied conditions cannot be reconsidered under section 167-15 (because none of the shares are debt interests) or section 167-20 (because its requirements are not met).

Therefore, Wooster Co reconsiders both of the unsatisfied conditions under section 167-25 as if its shares had fixed rights to receive dividends and capital distributions relative to their market value at certain valuing times determined by the last event.

The last event is the variation of rights on 1 July 2012. Therefore, the shares are valued immediately before and after the time of that event. Consequently:

- the rights to receive dividends and capital distributions attached to the ordinary shares are fixed at:
 - 55% (i.e., $\$55,000 \div \$100,000 \times 100$) before the event; and
 - 5% (i.e., $\$5,000 \div \$100,000 \times 100$) after the event; and
- the rights to receive dividends and capital distributions attached to the preference shares are fixed at:
 - 45% (i.e., $\$45,000 \div \$100,000 \times 100$) before the event; and
 - 95% (i.e., $\$95,000 \div \$100,000 \times 100$) after the event.

After reconsideration under section 167-25, Wooster Co is still unable to satisfy both of the unsatisfied conditions. In this regard:

- on 1 July 2011 Agatha had 55% of the rights and Bertram had 45% of the rights; and
- from 1 July 2012, Agatha has 5% of the rights and Bertram has 95% of the rights.

As only 50% of the rights have been continuously held throughout the ownership test period, both conditions in item 1 of the table in subsection 167-10(1) cannot be satisfied at all times during the ownership test period. Consequently, Wooster Co still fails the continuity of ownership test and is unable to deduct the tax loss in the 2012-13 income year.

Wooster Co has a taxable income (before deducting tax losses) of \$30,000 in the 2013-14 income year. It seeks to deduct the \$10,000 tax loss from its taxable income for the income year.

The ownership test period is from the start of the loss year (1 July 2011) to the end of the income year in which the loss is to be deducted (30 June 2014).

On 30 November 2013, there is a variation of the rights attached to the ordinary and preference shares to receive dividends and capital distributions. As a result:

- the market value of the preference shares increases to \$98,000; and
- the market value of the ordinary shares decreases to \$2,000.

As the different classes of shares have unequal rights, Wooster Co is still unable to satisfy the dividend and capital distribution conditions of the continuity of ownership test.

Section 167-30 prevents Wooster Co from reconsidering the continuity of ownership test under section 167-25 for the tax loss in the 2013-14 income year or in any subsequent income year because it failed to satisfy the reconsidered continuity of ownership test for that loss in the 2012-13 income year.

Consequently, Wooster Co is unable to deduct the tax loss in the 2013-14 income year.

If section 167-30 did not apply, Wooster Co would have been able to reconsider the continuity of ownership test under section 167-25. The last event would have been the variation of rights on 30 November 2013. As a result, Wooster Co would have been able to satisfy the dividend and capital distribution conditions of the continuity of ownership test, and therefore deduct the tax loss, in the 2013-14 income year.

Application of these modifications to consolidated groups

1.52 The operation of the continuity of ownership test is modified for the head company of a consolidated group or MEC group that is seeking to use losses transferred to the group from an entity that joins the group.

1.53 In the case of the head company of a consolidated group, section 707-210 applies for the purpose of working out whether a company (the latest transferee) can utilise for an income year a loss it made because of a continuity of ownership test transfer from another company (the latest transferor).

1.54 Consequential amendments ensure that, in working out whether section 167-25 applies to allow the latest transferee to utilise a loss for an income year, section 167-30 has effect as if references in that section to the subject company were references to the latest transferee. [*Schedule 1, items 36 to 38, subsections 707-205(1) and (2) and subsection 707-210(8)*]

1.55 Sections 719-255 and 719-260 apply for the purpose of working out whether a loss can be utilised for an income year (the claim year) by a company (the focal company) if:

- the continuity of ownership test is relevant to the question whether the focal company can utilise the loss; and
- the focal company is the head company of a MEC group at any time in its ownership test period for the loss.

1.56 Consequential amendments ensure that, in working out whether section 167-25 applies to allow the focal company to utilise a loss for a claim year, section 167-30 has effect as if references in that section to the subject company were references to the focal company. [*Schedule 1, item 39, subsection 719-260(5)*]

Companies with shares that have different voting rights

1.57 If, when working out an entity's voting power in a company at a particular time for the purposes of Part 3-5, the company's shares do not all at that time have the same voting rights for all matters affecting the company, the entity's voting power in the company at that time is worked out solely by reference to the maximum number of votes that could be cast on a poll:

- if the election of the company's directors is determined by the casting of votes attached to shares, on the election of a director of the company, if such a poll were to be held at that time; or

- otherwise, on the adoption of a constitution for the company or the amendment of the company's constitution, if such a poll were to be held at that time.

[Schedule 1, item 1, subsection 167-80]

Modifications to the same business test

1.58 The operation of the same business test will be modified for the head company of a consolidated group or MEC group. The modifications will clarify that, for the purpose of applying the same business test (section 165-210), the entry history rule (section 701-5) does not operate in relation to an entity becoming a subsidiary member of a consolidated group or a MEC group. *[Schedule 1, item 43, section 165-212E]*

1.59 The amendment clarifies that the head company of a consolidated group or MEC group does not need to take into account the history of a subsidiary member prior to the time that it joined the group for the purposes of determining whether it can satisfy the same business test.

Application and transitional provisions

Modifications to the continuity of ownership test — Subdivision 167-A amendments

1.60 The amendments in Subdivision 167-A (together with related consequential amendments), which allow a company that fails the continuity of ownership test because it has shares with unequal rights to dividends or capital distributions to be able to choose to reconsider the test after disregarding debt interests and secondary classes of shares, apply from 1 July 2002. *[Schedule 1, sub-items 42(1) to (3)]*

1.61 That is, the amendments in Subdivision 167-A (together with the related consequential amendments) will apply to:

- any tax loss for an income year commencing on or after 1 July 2002;
- any net capital loss for an income year commencing on or after 1 July 2002; and

- any deduction in respect of a bad debt that is claimed in an income year commencing on or after 1 July 2002.

[Schedule 1, paragraphs (a), (b) and (c) of sub-item 42(2)]

1.62 These amendments will also apply in determining whether any changeover time or alteration time occurred on or after 1 July 2002.

[Schedule 1, paragraph (d) of sub-item 42(2)]

1.63 In addition, these amendments will apply to:

- any tax loss of a company for an income year commencing on or before 30 June 2002 that could have been deducted, in accordance with Divisions 165 and 166 as in force at that time, in the first income year commencing after 30 June 2002 if the deduction had not been limited by the company's income for that income year; and
- any net capital loss of a company for an income year commencing on or before 30 June 2002 that could have been applied, in accordance with Divisions 165 and 166 as in force at that time, in the first income year commencing after 30 June 2002 if the application of the loss had not been limited by the company's capital gains for that income year.

[Schedule 1, sub-item 42(3)]

1.64 The amendments in Subdivision 167-A (together with related consequential amendments) apply from 1 July 2002 because they are beneficial to taxpayers. The amendments make it easier for companies to satisfy the continuity of ownership test. Therefore, the amendments will give companies greater access to deductions for prior year losses.

Modifications to the continuity of ownership test — Subdivision 167-B amendments

1.65 The amendments in Subdivision 167-B (together with related consequential amendments), which modify the basis for working out voting power for the purpose of applying the continuity of ownership test where the shares of a company have different voting rights, apply from 1 July 2007. *[Schedule 1, sub-items 42(1), (4) and (5)]*

1.66 That is, the amendments in Subdivision 167-B (together with the related consequential amendments) will apply to:

- any tax loss for an income year commencing on or after 1 July 2007;

- any net capital loss for an income year commencing on or after 1 July 2007; and
- any deduction in respect of a bad debt that is claimed in an income year commencing on or after 1 July 2007.

[Schedule 1, paragraphs (a), (b) and (c) of sub-item 42(4)]

1.67 These amendments will also apply in determining whether any changeover time or alteration time occurred on or after 1 July 2007.

[Schedule 1, paragraph (d) of sub-item 42(4)]

1.68 In addition, these amendments will apply to:

- any tax loss of a company for an income year commencing on or before 30 June 2007 that could have been deducted, in accordance with Divisions 165 and 166 as in force at that time, in the first income year commencing after 30 June 2007 if the deduction had not been limited by the company's income for that income year; and
- any net capital loss of a company for an income year commencing on or before 30 June 2007 that could have been applied, in accordance with Divisions 165 and 166 as in force at that time, in the first income year commencing after 30 June 2007 if the application of the loss had not been limited by the company's capital gains for that income year.

[Schedule 1, sub-item 42(5)]

Modifications to the same business test

1.69 The amendment to the same business test applies from 1 July 2002. *[Schedule 1, item 44]*

1.70 The amendment is beneficial to taxpayers as it clarifies the operation of the existing law and makes it easier for the head company of a consolidated group or MEC group to satisfy the same business test. Therefore, the amendment will give companies greater access to deductions for prior year losses.

Amendment of assessments

1.71 Generally, the Commissioner of Taxation can amend an assessment of a company, other than a small business entity, within four years from the date of the notice of assessment (section 170 of the *Income Tax Assessment Act 1936*).

1.72 As these amendments apply from 1 July 2002, the period for amending assessments will be extended. That is, the operation of section 170 will be modified so that it does not prevent the amendment of an assessment if:

- the assessment was made before the date of commencement of Schedule 1;
- the amendment is made within four years after that date; and
- the amendment is made for the purpose of giving effect to the amendments in Schedule 1.

[Schedule 1, item 45]

Consequential amendments

1.73 Consequential amendments are made to notes in Divisions 165, 166, 170 and 175 so that they appropriately refer to the modifications to the continuity of ownership test made by new Subdivisions 167-A and 167-B. *[Schedule 1, items 2 to 35 and item 40, sections 165-12, 165-37, 165-115C, 165-115L, 165-115X, 165-115Z, 165-123, 166-145, 166-175, 166-225, 166-230, 166-240, 166-255, 166-260, 170-260, 170-265, 175-10, 175-45, 175-85 and the definition of ‘eligible Division 166 company’ in subsection 995-1(1)]*

